89-336 (1)

No. ________

In The

Supreme Court of the United States

October Term, 1989

JEFFREY KRINSK,

Petitioner,

v.

FUND ASSET MANAGEMENT, INC., MERRILL LYNCH ASSET MANAGEMENT, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., MERRILL LYNCH & CO., INC., and CMA MONEY FUND,

Respondents.

Petition For a Writ Of Certiorari To The United States Court of Appeals For The Second Circuit

Melvyn I. Weiss
One Pennsylvania Plaza
New York, New York 10119
(212) 594-5300
Attorney for Petitioner

Of Counsel:

Richard M. Meyer
George A. Bauer III
Milberg Weiss Bershad Specthrie & Lerach
One Pennsylvania Plaza
New York, New York 10119

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QUESTIONS PRESENTED FOR REVIEW

1. (a) Do the 1970 Amendments to the Investment Company Act of 1940 ("ICA"), which expressly impose a "Fiduciary duty" upon an investment adviser with respect to its receipt of compensation from an investment company, permit an investment adviser to charge an investment company excessive fees, providing only that the aggregate fee is not "so disproportionately large that it bears no reasonable relationship to the services rendered"?

(b) Does the fiduciary duty imposed by the ICA prohibit an investment adviser from charging an investment company a substantially higher fee than it charges another company for the identical services (*i.e.*, must the adviser give an investment company its best deal), especially where the investment adviser reaps substantial incremental benefits from its management of the subject company?

2. Does Rule 12b-1, promulgated by the SEC under ICA § 12(b), prohibit the directors of a registered investment company from approving and continuing a so called 12b-1 plan which does not benefit the investment company's shareholders but which costs the investment company's shareholders over $21,000,000 per year?

3. May an investment adviser procure approval of an investment advisory agreement through the use of a proxy statement which makes a misleading comparision of the fee rates of a comparable investment company by omitting information concerning the other company's lower effective fee rate and lack of annual fees?

QUESTIONS PRESENTED FOR REVIEW (Cont.)

4. Did the Court below improperly deny plaintiff his constitutional right to trial by jury on his claims for money damages under ICA §§ 20(a) and 36(b)?

5. Does ICA § 15, which provides that no one may serve as an investment adviser to a fund "except pursuant to a written contract" which "precisely describes all compensation to be paid thereunder", permit an investment adviser to charge, through an affiliate, an annual "participation fee" to all fund shareholders, which fee is neither pursuant to a written contract nor approved by the fund's Trustees?

6. Did the Court below emasculate the investor protection provided by Congress in the Investment Company Act?

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OPINIONS BELOW

The District Court for the Southern District of New York entered a pre-trial opinion involved herein, and an opinion following a bench trial. On March 4, 1987 the District Court issued its opinion, 654 F.Supp. 1227 (App 1 – App 22*) dismissing plaintiff's claims under ICA §§ 12 and 15 and striking plaintiff's demand for a trial by jury. The remaining case was then tried before Judge Walker who filed his opinion dismissing plaintiff's claims under ICA §§ 20 and 36(b); [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,812 (June 27, 1988). (App 23 – App 100)

The Second Circuit Court of Appeals affirmed the judgment below by an opinion dated May 31, 1989, 875 F.2d 404. (App 101 – App 123)

JURISDICTION

The decision of the Court of Appeals for the Second Circuit was dated and filed on May 31, 1989. Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Seventh Amendment to the Constitution of the United States provides:

> In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved . . .

* "App" References are to the Appendix annexed hereto.

Due to their length, Sections 1, 12, 15, 20(a), 36(b) and 44 of the ICA and Rules 12b-1 and 20a-1 promulgated by the Securities and Exchange Commission, are set forth in the Appendix commencing at page App 124.

STATEMENT OF THE CASE

Petitioner is a shareholder of the CMA Fund and instituted this action for the benefit of the Fund. The CMA Fund, a registered investment company, is the largest money market fund in the nation, with over $19 billion in net assets. The Merrill Lynch[1] defendants manage the CMA Fund and act as its investment adviser.

To invest in the CMA Fund an investor must first participate in the Merrill Lynch sponsored Cash Management Account or CMA "Program"; invest $20,000 or more with Merrill Lynch, and pay Merrill Lynch a fee of $65 per annum. Merrill Lynch also charges the CMA Fund an investment advisory fee amounting to .38% of net assets for contractually delineated services. Merrill Lynch further charges the CMA Fund a so-called "12b-1" marketing fee which Merrill Lynch then distributes as bonuses

[1] Merrill Lynch, Pierce, Fenner & Smith, Inc. ("MLPF&S") is a securities firm sponsoring the CMA "Program" and the CMA Fund. The day-to-day management of the CMA Fund is performed by Merrill Lynch Asset Management, Inc. ("MLAM"). Both MLPF&S and MLAM are owned by Merrill Lynch & Co., Inc. ("ML&Co."). The CMA Fund's nominal investment adviser is Fund Asset Management, Inc. ("FAM"), a wholly owned subsidiary of MLAM. These companies, MLPF&S, MLAM, ML&Co. and FAM, were each named as defendants and are collectively referred to as "Merrill Lynch".

to its salesmen. These three charges result in a total annual levy of approximately .83% of net assets.

Merrill Lynch acts as the investment adviser to approximately forty-two investment companies. Only one of the other investment companies managed by Merrill Lynch is comparable to the CMA Fund. That investment company is the Ready Assets Trust ("RAT"). Like the CMA Fund the RAT is a money market mutual fund, investing in highly liquid short-term money market instruments. Both the RAT and the CMA Fund share the same investment objectives. The CMA Fund and the RAT are the two largest money market funds in the nation. Merrill Lynch provides the identical investment advice to both the RAT and the CMA Fund pursuant to virtually identical contracts with the two funds.

There are two differences between the funds. First, the CMA Fund is associated with a "central asset account". To invest in the CMA Fund you must become a participant in the CMA Program, pay Merrill Lynch $65 per year[2] and invest $20,000 with Merrill Lynch. There are no similar requirements for the RAT which is a stand-alone fund. Second, and more importantly, Merrill Lynch charges the CMA Fund a higher investment advisory fee, some $12,000,000 higher at the $20 billion asset level.

The CMA Fund's performance has been very volatile as a result of its policy of investing in "longer" short-term

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[2] The $65 fee was not approved by the CMA Fund's trustees; rather, it was unilaterally imposed by Merrill Lynch. It is not the subject of a written contract as required by ICA § 15.

investments. When adjusted to compensate for market risk,[3] as measured by portfolio volatility, the CMA Fund's investment performance during the time relevant to the suit was well below the performance figures for money market funds of other central asset accounts, as well as being below the Donoghue Index of money market funds generally.

The CMA Fund provided excessive profits to Merrill Lynch. Plaintiff's evidence showed that Merrill Lynch's weighted-average pre-tax Return on Equity for the 1984-1986 period from the fee-based side of the CMA Program was an unconscionable 132.6% per annum, far above any reasonable profit level. While the District Court disagreed with some of Plaintiff's submissions, even the District Court's analysis, undisturbed by the Court of Appeals, showed a hefty $22.6 million profit to Merrill Lynch in the first six months of 1986 alone. This is equivalent to a 72.99% Return on Equity to Merrill Lynch[4] from the CMA Fund, still an unreasonably excessive profit level. The Return on Equity to Merrill Lynch far exceeds the 8.4% average return received by the CMA Fund's shareholders during the years 1984-1986.

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[3] The District Court acknowledged that risk adjustment to return is appropriate. A portfolio with greater volatility should be expected to earn a greater return. (App 57) However, the Courts below did not hold the trustees or the adviser to the high standard of a fiduciary by requiring them to evaluate the fund's performance in the light of such risk factors.

[4] The Court of Appeals erroneously rejected plaintiff's use of the "Dupont formula" for calculating the Return on Equity

(Continued on following page)

In addition to the fee-based profits Merrill Lynch received from the CMA Fund, Merrill Lynch received tremendous other benefits from the CMA Fund shareholders which were integrally related to the CMA Fund. Thus, for example, during the 1985-1986 period, securities trading commissions in the CMA Program accounts contributed an average of $92,555,000 to Merrill Lynch's profit annually, funds management fees from other investment companies in the CMA Program contributed an average of $3,750,000 per year to Merrill Lynch and margin interest charged to CMA program customers contributed $49,562,000 a year to Merrill Lynch's profits. The income received from CMA accounts was far greater than that flowing from other Merrill Lynch customers.

Merrill Lynch has enjoyed economies of scale in that its costs have not risen as fast as its income as the CMA Fund grew larger. The District Court found "that plaintiff's exhibits showed that fee-based expenses expressed as a percent of fee-based revenues did decrease at a time when Fund size grew." (App 80) Nevertheless Merrill Lynch has not lowered the fee rate charged to the CMA Fund and has not shared these economies of scale with the CMA Fund's shareholders.

(Continued from previous page)

to Merrill Lynch stating that plaintiff's "expert lacked the asset turnover and leverage figures for the Fund or the CMA Program". (App 114, fn.4) Contrary to the Court of Appeals' erroneous assumption, it is the profitability of the Fund to Merrill Lynch, not to the CMA Program or the Fund itself, which must be scrutinized, and the appropriate figures were available and were used by plaintiff's expert.

Comparison of the fees charged to other investment companies is of limited value since there is no real competition among advisers for an investment company's business and because few investment companies are even a fraction of the size of the CMA Fund. The RAT Fund is almost as big as the CMA Fund and is also advised by Merrill Lynch. At an effective advisory fee rate of .34%, RAT pays advisory fees 10% less than the CMA Fund pays for the same advisory service.

The CMA Fund's trustees were all selected by Merrill Lynch. The trustees have not acted conscientiously or independently. One trustee testified that if he disputed management "he would be thrown out the nearest window." Another trustee voted for the adoption and continuation of a so-called "12b-1 plan" to use fund assets to pay bonuses to Merrill Lynch salesmen purportedly to increase the asset size of the Fund. This was despite the fact that the same trustee contemporaneously published an article concluding that a "fund's asset size has no significant influence on its performance". Two of the trustees who had approved the CMA Fund management fee year in and year out could not state what that fee was.

Merrill Lynch provides the identical contractually defined investment advisory services to the RAT. Petitioner contended that under a fiduciary duty standard, the fiduciary is required to charge its *cestui* a fee no higher than the fee it charges to anyone else for the same services, i.e., the *cestui* must be given the fiduciary's "best deal". Since Merrill Lynch charges the CMA Fund $12,000,000 more than it would charge the RAT for the contractually identical services, petitioner alleged that Merrill Lynch breached its fiduciary duty.

The Court of Appeals explicitly rejected petitioner's contention that the fiduciary duty imposed by § 36(b) required Merrill Lynch to give the CMA Fund its "best deal". The court effectively eliminated the fiduciary duty standard, saying that "to violate Section 36(b), 'the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered' ". (App 110) The Court of Appeals thereby erroneously reimposed the "excessively excessive" or "corporate waste" standard that Congress rejected in 1970 when it amended the Investment Company Act.

Not only is the advisory fee excessive in comparison to the lower fee Merrill Lynch charges the RAT, the advisory fee charged to the CMA Fund results in clearly excessive profits to Merrill Lynch. The profitability of a fund to its investment adviser is a primary factor in determining whether a management fee is excessive.

Plaintiff contended that such excessive profitability alone should suffice to support a finding of unreasonableness. The Court of Appeals also rejected this argument. (App 112) Thus the courts below would allow an adviser to take excessive profits from a registered investment company. The courts below did not specify any offsetting benefits to the Fund that would justify an excessive profit to Merrill Lynch.

Section 12(b) of the ICA mandates that an investment company acting as a distributor of its own securities comply with the rules and regulations promulgated by the SEC. Under Rule 12b-1 the investment company's directors are held to the fiduciary standards of § 36 when

they consider whether to implement or continue a distribution plan. Rule 12b-1 authorizes payments to be made from an investment company's assets only under certain rigid conditions. The rule was designed to enable small funds to grow large enough to enjoy economies of scale.

Merrill Lynch caused the CMA Fund to adopt a distribution plan pursuant to which the CMA Fund pays Merrill Lynch employees a percentage of the CMA Fund's entire assets, whether or not such employees sell any shares in the CMA Fund. The distribution plan costs CMA Fund shareholders over $21 million annually.

Rule 12b-1(e) requires the directors to have concluded, in good faith, that the institution and continuation of a distribution plan will benefit the company and its shareholders. In violation of such rule, the CMA Fund's trustees have implemented and continued a 12b-1 distribution plan which the trustees did not conclude would benefit the company and its shareholders and which plan does not in fact benefit the company or its shareholders.

The courts below rejected petitioner's claims under § 12(b) and Rule 12b-1 as indistinguishable from a claim under § 36(b). Clearly the intent and purposes of §§ 12 and 36 are different and are designed to protect fund shareholders from different wrongs. Impermissible distribution expenses prohibited under § 12 cannot be validated by assuming that they could have been extracted as management fees.

Merrill Lynch solicited approval of the CMA Fund's investment advisory fee by the use of a Proxy Statement[5] which listed the other funds advised by Merrill Lynch and purported to show their fee rates. RAT was the only such fund of comparable type and size to the CMA Fund. In explicitly stating that the CMA and RAT's initial advisory fees were .50% and that their first break points[6] both occurred at $500 million, the respondents gave the false impression in the Proxy Statement that the RAT's fee structure was the same as the CMA Fund. The Proxy Statement omitted to disclose that the RAT had more fee breaks and lower incremental fee rates than CMA. The CMA Proxy Statement also omitted to state that the RAT did not require the $65 annual service fee charged to CMA Participants. Petitioner asserts that this information was material to shareholders who were being asked to vote upon the continuation of the advisory contract.

Plaintiff alleged that the false and misleading Proxy Statement was in violation of ICA § 20. The Proxy Statement, sent to all CMA Fund shareholders, was used to obtain shareholder approval of the excessive investment advisory fees charged by Merrill Lynch.

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[5] A copy of the Proxy Statement is annexed hereto at pages App 155 to App 203.

[6] A break point is a stated amount of assets under the investment advisers' management, above which amount the adviser will charge a lower fee rate. Merrill Lynch charged the Fund an annual fee of .50% of the first $500 million of assets, .425% of the next $500 million and .375% of all assets in excess of $1 billion.

The courts below dismissed plaintiff's claim that the Proxy Statement's comparison of only the initial fee rate and initial break point was misleading and instead adopted the defendants' paternalistic argument that truthful "comparisons would confuse rather than assist the investor." (App 121)

In affirming the dismissal of plaintiff's Proxy claim, the Court of Appeals also mistakenly stated that the misstatement was immaterial because the "[Proxy] statement cautioned that 'investors seeking solely to invest cash in a money fund . . . should consider as a more suitable investment other money funds.' [And] the RAT fees were readily available, for instance, on the RAT proxy statements." (App 122) The CMA Fund Proxy Statement simply does not contain such a statement. The RAT Proxy Statement was not sent to CMA Fund shareholders. The misstatements' materiality was not fairly weighed and should have been determined on the facts and by a jury.

Plaintiff also alleged that the $65 annual participation fee charged by Merrill Lynch to CMA Program participants, including all CMA Fund shareholders, was in violation of ICA § 15 which requires *all* compensation paid to an investment adviser to be "precisely described" in a written contract with the investment company. No contract covers the participation fee charged by Merrill Lynch to CMA Fund shareholders. The courts below dismissed the claim saying that the participation fee was not "advisory" compensation, but the statute requires *all* compensation to be described in a written contract, not just the "advisory" fee.

Pursuant to ICA § 36(b)(3), an action may be brought for "damages or other relief". The Complaint herein seeks only damages and demand was made for a jury trial.

The courts below denied plaintiff his right to a trial by jury holding that only equitable claims were involved notwithstanding plaintiff's claims for damages only and despite ICA § 36(b)'s references to plaintiff's right to sue for damages in an "action at law" and notwithstanding plaintiff's claims for damages based upon Defendants' proxy violations.

REASONS FOR GRANTING THE WRIT

Summary of Argument

The Court of Appeals has decided important questions of federal law concerning the scope of the investor protection provided by the ICA, *i.e.*, the appropriate standard by which to judge a claimed breach of the fiduciary duty imposed under § 36(b) of the ICA, which standard has not been, but should be settled by this Court. The Second Circuit's ruling, which substantially lowers the standard of a fiduciary duty, is in conflict with the law in other circuits, notably the 6th, 7th and 11th Circuits, as well as prior precedents in the 2nd Circuit.

The applicable standard is of critical importance, not only in the instant action involving the management of a fund containing almost twenty billion dollars, but for all funds registered under the Investment Company Act which today manage assets in excess of one trillion

dollars.[7] The Court of Appeals decision effectively negates the fiduciary duty Congress imposed upon fund managers and advisers with respect to compensation they receive from the funds they manage. By focusing exclusively on two sentences from its earlier opinion in *Gartenberg v. Merrill Lynch Pierce Fenner & Smith. Inc.*, 694 F.2d 923, 928 (2d Cir. 1982), *cert. denied*, 461 U.S. 906 (1983), the court ignores language in that opinion, based upon the statute and its legislative history, that fees must be reasonable. The test adopted by the Court of Appeals is not the "fiduciary duty" test as mandated by the statute but is the virtual equivalent of the "excessively excessive" or "corporate waste" standard which Congress intended to repeal.

Application of the standard announced by the Court of Appeals makes clear that the Court left virtually no room for the investor protection intended to be provided by the statute.[8]

Furthermore, the courts below erred in applying even the standard they announced. The fee Merrill Lynch has charged the CMA Fund is in fact so disproportionately large that it bears no reasonable relationship to the services rendered. The decision should be reversed.

Second, the Court of Appeals' decision rejecting an implied right of action under § 12(b) of the ICA

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[7] IBC/Donoghue's *Money Fund Report*, June 2, 1989 at 1.

[8] The *Wall Street Journal* reported that the decision is a deterrent to potential plaintiffs from bringing lawsuits challenging excessive advisory fees. *Wall Street Journal*, June 2, 1989, at C. 1, Col. 5.

determined another important question of federal law in conflict with this Court's determinations in similar contexts. By rejecting petitioner's claim as indistinguishable from the claim under § 36, the Court of Appeals has diluted important protections against wasteful distribution expenses. The Court of Appeals' decision both failed to scrutinize the distribution fees under § 12, saying that they would be reviewed as part of the management fees under § 36, and then ignored the distribution fees in its § 36 analysis "as a wash" because they were paid out to Merrill Lynch employees. Thus, the fees totally escaped court review.

Third, the Court of Appeals' decision on proxy fraud materiality is inconsistent with the teachings of this Court in *Basic v. Levinson*, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988); and *TSC v. Northway*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). It was the defendants who offered the comparison between CMA and RAT, but did so in a misleading way. The caveat quoted by the Court was not contained in the proxy statement; nor could the CMA shareholders be required to request the RAT prospectus to search out the correct information.

Fourth, plaintiff's constitutional right to a jury trial was denied. Plaintiff had a clear right to a jury trial on the proxy fraud claim as well as on the claim for damages under § 36(b).

Finally, the courts below ignored the express language of § 15 of the ICA requiring *all* compensation paid to the investment adviser to be precisely described in a written contract approved by the directors, and the courts erroneously limited the statute to require written contracts for "advisory" fees only.

I.

The Courts Below Adopted a Standard Which Vitiates the Fiduciary Duty Imposed by Congress and is in Conflict With the Decisions of Other Circuits

Section 36(b) of the ICA was amended in 1970 to require investment advisers to be held to a higher standard than "gross" unreasonableness. The amendments were designed to "encourage greater scrutiny of adviser contracts." *Daily Income Fund, Inc. v. Fox,* 464 U.S. 523, 538, 104 S.Ct. 831, 839 (1984). The legislative history of the 1970 amendment is replete with Congressional dissatisfaction of the prior "excessively excessive" or "corporate waste" standards the Courts had applied under the "gross unreasonableness" language of the former statute.

For example, the Securities and Exchange Commission's letter of transmittal to Congress initially introducing the legislation to amend the ICA stated:

> Areas of primary concern in the report included the costs of management and sales charges . . . . Traditionally these contracts have provided for compensation on the basis of a percentage of the assets of a fund. As the funds have grown in size the amounts of management fees have likewise grown and the Commission's report concluded that economies of scale in the costs of managing large pools of assets have seldom been shared equitably with investment company shareholders . . . . A requirement that the fee be reasonable would appear inherent in the fiduciary relationship between investment company shareholders and an investment advisory organization which is in effective control of the fund. The existing provisions of the Investment Company Act, however, provide no adequate means by which such a requirement may be enforced.

Remarks by Messrs. Sparkman and Williams upon introduction of S.1659, May 1, 1967, 113 Cong. Rec. 11256-58 (1967). Similarly in 1968 Senator Sparkman, Chairman of the Committee sponsoring the amendments, said to the Senate:

> The requirements written into the original act that advisory contracts be approved by shareholder vote, by unaffiliated directors, or both – intended to provide adequate shareholder protection – has had the opposite effect. Courts have held that because of these statutory requirements allegedly excessive management fees are subject to judicial review only under the test of "corporate waste" or when they shock the conscience of the Court. This standard has been characterized by an eminent jurist as meaning that fees are subject to attack only when they are "excessively excessive".
>
> The proposed legislation would cure that deficiency.

Senate consideration of S.3724, July 24, 1968, 114 Cong. Rec. 23051 (1968).

In discussing the meaning of the "corporate waste" standard that had previously been in effect and that was to be rejected by the new legislation, Senator Sparkman said:

> The test of corporate waste . . . has been defined in [*Saxe v. Brady*, 184 A.2d 602] as to whether the compensation is so excessive that no person of ordinary and sound business judgment would determine it to be worth what the corporation has paid.

Senate consideration of S.3724, July 26, 1968, 114 Cong. Rec. 23535 (1968).

This description of the standard Congress sought to reject is the substantive equivalent of the standard the Court of Appeals has now erroneously adopted.

Congress' intention was quite explicit. In 1969, the Senate Report on this bill stated:

> [U]pon a challenge in court to compensation payments, the ultimate test, even if the compensation or payments are approved by the directors and stockholders, will not be whether it involves a "waste" of corporate assets but will be whether the investment adviser has fulfilled his fiduciary duty to the mutual fund shareholders in determining the fee.

Senate Report No. 91-184, 91st Cong., 1st Sess. 1969 (accompanying S.2224, 91st Cong., 1st Sess. (1969)).

When asked to define the "fiduciary duty" Representative Moss, who was one of the chief sponsors of § 36(b) in the House of Representatives, stated:

> [I]t is a matter of legal obligation to so administer and to so charge the fund that he does not commit an excess against the fund. There is a judgmental factor in it. It is for all practical purposes a work [sic] of art in law.
>
> At the present time the fund manager can only be acted against if he charges what are in effect excessively excessive charges for services. This, by imposition of the fiduciary duty, would in effect require a standard of reasonableness in the charges.

House consideration and passage of HR 17333, Sept. 23, 1970, 116 Cong. Rec. 33281 (1970).

Amended § 36(b) rejects the corporate waste or gross unreasonableness standard and imposes fiduciary duties

on a fund's investment adviser in connection with any compensation received by the adviser from the fund or its shareholders. ICA § 36(b)(l) specifically provides that a plaintiff is not required to show personal misconduct on the part of the adviser in order to prove a breach of fiduciary duty claim.

By imposing a fiduciary duty standard on the investment adviser, ICA § 36 requires the adviser to give the fund its best deal. As Abraham L. Pomerantz said in a symposium on the then proposed amendments to ICA Section 36, "it is the director's duty to get the best deal he can for his shareholders" 115 U. Pa. L. Rev. 659, 761 (1967).

The Court of Appeals decision herein effectively eliminates the fiduciary duty and holds that in order to violate § 36(b) "the adviser manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered" (App 110) which is nothing other than the rejected "corporate waste" or "excessively excessive" standard. By imposing such a difficult standard, the Court of Appeals has effectively nullified the protections of § 36 of the ICA.

Fiduciaries are supposed to be held to a higher standard than "the mere morals of the marketplace", *Meinhard v. Salmon,* 249 N.Y. 458 (1928) (Cardozo J.). The Court of Appeals decision is in conflict with several other circuits where fiduciaries are strictly held to have an obligation to get the "best deal" for their *cestui,* particularly where conflicts of interest are involved. *Edelman v. Fruehauf Corp.,* 798 F.2d 882, 887 (6th Cir. 1986) (it is a director's duty "to see that the shareholders obtain the

best price possible for their stock"); *Stone Mountain Game Ranch, Inc. v. Hunt,* 746 F.2d 761, 765 (11th Cir. 1984) (fiduciary "had an affirmative duty to [its *cestui*] to get the best deal it could"); *United States v. Bush,* 522 F.2d 641, 648 (7th Cir. 1975), *cert. denied,* 424 U.S. 977 (1976) ("The deal may have been a good one for the [*cestui*]; the problem is that [the fiduciary] deprived the [*cestui*] of making a better deal, of the best deal possible, in order that he might share in the profits."). *See also Weinberger v. UOP, Inc.,* 457 A.2d 701, 710 (Del. Supr. 1983) (director of corporation, dealing with it, has a duty to do what is best for the corporation).

By denying that an investment company fiduciary has a duty to get the best deal for its fund shareholders, the Second Circuit has placed itself in conflict with the 6th, 7th and 11th Circuits' holdings that fiduciaries should get the best deal they can for their *cestui.*

II.

The Court of Appeals' Holding That No Private Right of Action Lies Under ICA § 12 Is in Conflict with Decisions of This Court

It is the declared policy of the ICA that investment companies are to be organized, operated and managed in the interest of the company's security holders and not for the benefit of its investment adviser or their affiliates. ICA § 1.

In furtherance of this policy ICA § 12(b) makes it unlawful for an investment company to act as a distributor of its own securities except pursuant to rules and regulations prescribed by the SEC. However, in order that

very small funds might grow and realize economies of scale, the SEC adopted Rule 12b-1.

Plaintiff's complaint alleges that the distribution agreement and plan entered into and continued by CMA Fund violates Rule 12b-1 and § 12(b). The plan imposed upon the CMA Fund by Merrill Lynch requires the Fund to pay Merrill Lynch .125% of the average daily net assets of the Fund. These amounts are paid by the Fund on its entire asset base whether or not even one additional share is sold. Due to the absence of fee-breaks over the $1 billion asset level and the absence of any correlation between size and yield, the CMA Fund derives no benefit from the 12b-1 plan, whether it is effective in causing the sale of additional shares, or, as plaintiff believes, it is not.

Rule 12b-1(e) requires the directors who vote for the adoption or continuation of a distribution plan to have concluded, in good faith, that the institution and continuation of the plan would benefit shareholders. The CMA Fund trustees did not have such a belief when they voted to approve the plan involved here. Moreover, the Plan is invalid because the "disinterested" trustees were selected by Merrill Lynch contrary to the mandate in sub-paragraph (c) of Rule 12b-1.

The courts below dismissed plaintiff's claims under § 12(b) and Rule 12b-1, erroneously concluding that plaintiff's claim under § 12(b) is indistinguishable from his § 36(b) claim, and effectively holding that no right of action exists under § 12. (App 15-16 and App 119-120)

The four factors cited in *Cort v. Ash*, 422 U.S. 66 (1975) support a finding of a private right of action under § 12(b). First, plaintiff as a shareholder in an investment

company is clearly "one of the class for whose *especial* benefit the statute was created" 422 U.S. at 78 (*quoting, Texas & Pacific R. Co. v. Rigsby,* 241 U.S. 33, 39 (1916)). Second, the Investment Company Act and its legislative history demonstrate a concern that fund shareholders were being oppressed and were not obtaining judicial relief. No intent to deny a private right of action is apparent in the Act, its amendments, or its legislative history. To the contrary, the legislative history is replete with concerns that shareholders be able to effectively sue for relief. *See,* for example, the Senate and House Reports accompanying the 1980 amendments to the ICA which reaffirmed Congressional reliance on private rights of action to enforce the ICA. Senate Report No. 96-958 at p. 14 (1980); House Report No. 96-1341 at p. 29 (1980). Third, it is absolutely consistent with the underlying purposes of the legislative scheme of full disclosure and shareholder enforcement to imply such a remedy for the plaintiff. Fourth, this is not an area traditionally left to state law but rather has been held to uniform federal standards.

The courts below misapprehended the import of § 12(b) as directed solely at excessive compensation to the adviser and therefore found that the express private right of action under § 36(b) was an adequate remedy which in this case precluded a private cause of action under § 12(b) as well.

Plaintiff submits that the payments under the 12b-1 plan, which are made not for the benefit of the Fund's shareholders but solely for the benefit of Merrill Lynch, not only compound the excessive fees Merrill Lynch receives in violation of § 36(b), but they constitute an

independent violation of § 12(b) and Rule 12b-1, whether or not the total compensation received by the adviser is excessive. In other words, a conversion of shareholder assets in violation of § 12(b) is an actionable event even if in total the compensation received by the investment adviser does not reach the level required under § 36(b). The courts below were in error in dismissing the § 12 claim.

The courts' opinions below would read § 36(b), added in 1970, as a severe limitation by Congress on the availability of private causes of action. However, nowhere in the 1970 amendments did Congress repudiate the existing law on private causes of action or express any disagreement with the implication of such remedies. Thus it is clear that the 1970 amendments did not represent any intention by Congress to eliminate any damage remedies which had been implied under the Act. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran,* 456 U.S. 353, 387-88, 102 S.Ct. 1825, 1843-44, 72 L.Ed.2d 182 (1982). As the Court held in *Tannenbaum v. Zeller,* 552 F.2d 402, 417 (2d Cir.), *cert. denied,* 434 U.S. 934 (1977): "Congress did not intend this modification [addition of § 36(b)] to abrogate the private action already recognized under the Act for other types of breach of fiduciary duty". *See also Lessler v. Little,* 857 F.2d 866 (1st Cir. 1988); *Fogel v. Chestnutt,* 668 F.2d 100, 111-12 (2d Cir. 1981), *cert. denied,* 459 U.S. 828 (1982).

Implied private rights of action have been upheld under various sections of the ICA including § 12. *Bancroft Convertible Fund v. Zico Investment Holdings, Inc.,* 825 F.2d 731, 735 (3d Cir. 1987) (§ 12); *Lessler v. Little,* 857 F.2d at 873 (§ 17); *Meyer v. Oppenheimer Management Corp.,* 764

F.2d at 85, (§§ 12, 15); *Jerozal v. Cash Reserve Management. Inc.*, [1982-83 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶99,019 (S.D.N.Y. August 10, 1982) (§ 15); *Fogel v. Chestnutt*, 668 F.2d at 105-112. The courts below erred in holding otherwise.

III.

The Court of Appeals' Sanctioning Of Misleading Comparisons Of Investment Advisory Fees In Proxy Statements Is In Violation Of ICA § 20 and In Violation of Principles Announced By This Court in *Basic v. Levinson*

ICA § 20(a) and Rule 20a-1 promulgated thereunder forbid solicitation of proxies containing any materially false or misleading statement or omission. Rule 20a-1 incorporates the restrictions of the SEC Rules governing proxies under § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(a) (1982).

In violation of these rules, Merrill Lynch solicited proxies from CMA Fund shareholders by the use of a misleading Proxy Statement. The Proxy Statement compared Merrill Lynch sponsored investment companies including the RAT and the CMA Fund. The comparison chart (App 172) compared the investment companies' "Net Assets as of June 15, 1984" and their "Management Fee" including "Rate (Percentage of net assets)" and their "First Breakpoint". The amounts displayed for the CMA Fund and the RAT were identical, despite the fact that the RAT actually has more fee breaks, lower incremental fees, a lower overall effective fee rate, and does not require the annual participation fee imposed on CMA Program Participants.

The CMA Fund shareholder was not informed that he was being asked to approve a higher investment advisory fee on his investment than RAT shareholders were paying for the exact same services.

The District Court and the Court of Appeals dismissed this claim "agreeing with Merrill Lynch that because the CMA Fund and the RAT are so different, comparisons would confuse rather than assist an investor, and that the omission was immaterial".

The lower courts' opinions authorizing misleading statements to avoid "confusing" shareholders are inconsistent with this Court's holding in *Basic Incorporated v. Levinson,* 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). In *Basic* the defendant argued that full disclosure in the context of merger discussions should not be required so "that an investor not be overwhelmed by excessively detailed and trivial information". This Court held that this rationale

> stands soundly rejected. . . ."It assumes that investors are nitwits. . . ." Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress. We have recognized time and again, a "fundamental purpose" of the various securities acts, "was to substitute a policy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Capital Gains Research Bureau. Inc.,* 375 U.S. 180, 186, 84 S.Ct. 275, 280, 11 L.Ed.2d 237 (1963). Accord, *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 151, 92 S.Ct. 1456, 1471, 31 L.Ed.2d 741 (1972); *Santa Fe Industries Inc. v. Green,* 430 U.S. 462, 477, 97 S.Ct. 1292, 1303, 51 L.Ed.2d 480 (1977). The role of the materiality requirement is

> not to "attribute to investors a childlike simplicity, or inability to grasp the probabilistic significance of negotiations, *Flamm v. Eberstadt*, 814 F.2d [1169, 1175 (7th Cir.) cert. denied ___ U.S. ___, 108 S.Ct. 157, 98 L.Ed.2d 112 (1987)] but to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger "mix" of factors to consider in making his investment decision. *TSC Industries, Inc. v. Northway, Inc.*, [426 U.S. 438, 448-49, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 275 (1976)]".

485 U.S. at ___, 108 S.Ct. at 984-85.

The Court of Appeals' opinion was also based on an erroneous statement that the Proxy Statement contained a caveat that "investors seeking solely to invest cash in a money fund . . . should consider as a more suitable investment other money funds." No such statement is contained in the Proxy Statement and the Second Circuit was simply wrong about this.

The Second Circuit also stated that the RAT fees were readily available in the RAT Proxy Statement. But the RAT Proxy Statement was not sent to CMA Fund shareholders.

It was the defendants who offered the comparison of the CMA fee to the RAT fee, but did so in a false and misleading manner, omitting the significantly lower fee rates actually paid by RAT. There was a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available" *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. at 449, 96 S.Ct. at 2132. The information was material and should have been required to be disclosed.

IV.

Plaintiff's Constitutional Right To A Trial By Jury Was Denied

A. Plaintiff Was Entitled To A Jury Trial Under § 36(b)

Section 36(b) authorizes a shareholder of an investment company to bring an action against an investment adviser or any affiliated person of an investment adviser to recover "damages" or to seek "other relief" with respect to payments made within one year of when the action was initiated.

Thus, under § 36(b) a plaintiff shareholder may seek either damages on the one hand or, on the other hand, equitable relief, such as an accounting or injunctive relief requiring the reduction of fees *in futuro*. The availability of alternative types of relief is confirmed by § 44 of the ICA.

ICA § 44, upon which jurisdiction of this action is based, confers jurisdiction upon Federal District Courts over "all suits in equity and actions at law brought to enforce any liability or duty created by" the Act. The Section thus draws the traditional distinction between a suit in equity and an action at law. With specific reference to § 36(b), § 44 goes on to provide "the [Securities and Exchange] Commission may intervene as a party in any *action or suit* to enforce any liability or duty created by, or to enjoin any non-compliance with, Section 36(b) of this title at any stage of such *action or suit* prior to final judgment therein". (Emphasis and interpolation supplied). Congress thus recognized in § 44 that a shareholder's claim under § 36(b) could be either a legal action

(if it sought damages) or an equitable suit (if it sought equitable relief).

However, the Courts below held, in effect, that § 36(b) creates a claim for equitable relief only. (App 20, App 122) In this respect the Court of Appeals placed itself in opposition, not only to the statutory language, but to its earlier holding in *In Re Gartenberg*, 636 F.2d 16 (2d Cir. 1980), *cert. denied*, 451 U.S. 910 (1981). In that case, the Court was careful to point out the distinction between a § 36(b) claim for equitable relief and one advancing a *bona fide* claim for damages. The Court noted that, to determine whether a plaintiff's action is in law or equity, "we must look to the relief which he seeks". 363 F.2d at 18. If the plaintiff asserts a *bona fide* claim for damages, the Seventh Amendment entitles the parties to a jury trial; *Ross v. Bernhard*, 396 U.S. 531, 533, 90 S.Ct. 733, 24 L.Ed.2d 729 (1970).

In the present case, the complaint asks only that the defendants be required to pay damages. Contrary to the lower court's characterization, the claim is not one for restitution. Nor does the Complaint here seek "equitable disgorgement and an accounting" or "rescission" and "restitution" as in *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 835 F.2d 45, 46 (2d Cir. 1987), *cert. denied*, ___ U.S. ___, 108 S.Ct. 1594 (1988).

In short, where a statute such as § 36(b) creates a right to recover damages, and damages is the sole relief prayed for, "The Seventh Amendment . . . requires a jury trial upon demand . . . ;" *Curtis v. Loether*, 415 U.S. 189,

194, 94 S.Ct. 1005, 39 L.Ed.2d 260 (1974). *See also Kamen v. Nordberg,* ___ U.S. ___, 108 S.Ct. 1119, 1120, 99 L.Ed.2d 279 (1988) (dissenting opinion).[9]

B. Plaintiff Is Entitled To A Jury Trial Under The Proxy Fraud Claim Under ICA § 20

The right to a jury trial under a claim of proxy fraud where money damages only are sought is clearly established; *Dasho v. Susquehanna Corporation,* 461 F.2d 11, 31 (7th Cir.), *cert. denied,* 408 U.S. 925 (1972).

The Court below denied plaintiff his right to a jury trial on his proxy fraud claim holding that "a proxy misrepresentation that results in the continuation of a contract for advisory fees . . . would lead to equitable relief". (App 123)

Here, however, the damages resulting from the misleading proxy are central to the plaintiff's case. Plaintiff seeks damages, not, at this late date "a new shareholders vote". (App. 123) The shareholders' vote was sought for

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[9] Indeed, although § 36(b) changed the "standards employed by courts to judge [adviser's] fees," *Daily Income Fund v. Fox,* 464 U.S. 523, 537, 104 S.Ct. 831, 78 L.Ed.2d 645 (1984), the action is still analogous to an action for diversion of corporate assets. S. Rep. No. 91-184, at 5, 91st Cong. 2d Sess. (1970). Such an action is "one asserting a claim *in law* . . ." *Lewis v. S. L. & E., Inc.,* 831 F.2d 37, 39 (2d Cir. 1987) (emphasis added); *see also Ross v. Bernhard,* 396 U.S. at 542 (derivative claim that investment adviser extracted excessive brokerage fees from the corporation entitled plaintiff to a jury's determination of damages under the brokerage contract); *Simler v. Conner,* 372 U.S. 221, 223, 83 S.Ct. 609, 9 L.Ed.2d 691 (1963) (suit by client against lawyer charging excessive fees is "a traditionally 'legal' action").

approval of the advisory agreement. Accordingly, the plaintiff is entitled, under *TSC Industries v. Northway*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), to a jury determination of the materiality of the misstatements.

V.

The Court Below Thwarted Congress' Purpose By Dismissing The Claim Under § 15(a)

The District Court dismissed plaintiff's claim under § 15(a) before trial and the Court of Appeals affirmed. ICA § 15(a) provides that no one may serve as an investment adviser to a fund except pursuant to a written contract which "precisely describes all compensation to be paid thereunder".

It is undisputed that every investor in the CMA Fund is subject to a recurring annual service fee at the rate of $65, imposed unilaterally by Merrill Lynch. The Funds' trustees neither approve nor disapprove such fee. The fee is not the subject of a written contract.

The opinions of the courts below ignore the express language of the statute requiring "all compensation" to be precisely described and instead misread it to say that only "advisory compensation" need be described. (App 120) The courts below then purport to distinguish the $65 participation fee from advisory compensation. The short answer to this argument is that the statute requires *all compensation* to be precisely described in a written contract approved by the trustees or the shareholders. There is no limitation that only "advisory" compensation be described. Otherwise, unscrupulous advisers could easily

evade the requirements of § 15 of the ICA by the simple expedient of calling their fees by different names.

The court below also improperly upheld the dismissal of petitioner's § 15 claim saying it was not the proper subject of a derivative claim, citing *Cohen v. Fund Asset Management Inc.*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶98,433 (S.D.N.Y. March 31, 1980).

Unlike the sales loads in *Cohen* which were charged individually to new entrants in the fund there, here Merrill Lynch uniformly charges all Fund shareholders a recurring annual participation fee. *Cohen* is thus factually inapplicable here.

CONCLUSION

For all of the foregoing reasons, petitioner urges the Court to grant his petition for a writ of certiorari.

Respectfully submitted,

MELVYN I. WEISS
One Penn Plaza
New York, New York 10119-0165
(212) 594-5300

Attorney for Petitioner

Of Counsel:

RICHARD M. MEYER
GEORGE A. BAUER III
MILBERG WEISS BERSHAD
SPECTHRIE & LERACH
One Penn Plaza
New York, New York 10119-0165

Jeffrey KRINSK, Plaintiff,

v.

FUND ASSET MANAGEMENT, INC., Merrill Lynch Asset Management, Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Merrill Lynch & Co., Inc., and CMA Money Fund, Defendants.

No. 85 Civ. 8428 (JMW).

United States District Court,
S.D. New York.

March 4, 1987.

Shareholder filed suit alleging specific violations of the Investment Company Act in connection with allegedly excessive fee payments. A motion to dismiss was filed. The District Court, Walker, J., held that: (1) a private action could be maintained under the section controlling proxy solicitations, apart from a private action for breach of fiduciary duty; (2) there was no private right of action under the section prohibiting an investment company from acting as a distributor of its own securities where the issue was excessive fees; (3) the shareholder could not maintain a derivative action; and (4) the shareholder was not entitled to a jury trial.

Complaint dismissed in part and jury demand stricken.

Richard M. Meyer of Milberg Weiss Bershad Specthrie and Lerach, New York City, for plaintiff.

James K. Manning, Paul Windels, III, Amy J. Leeson of Brown and Wood, New York City, for defendant CMA Money Fund.

James N. Benedict, Mark Holland of Rogers & Wells, New York City, for defendant Fund Asset Management Inc.

OPINION

WALKER, District Judge:

INTRODUCTION

Plaintiff Jeffrey Krinsk brings this action on behalf of the CMA Money Fund ("Fund"), of which he is a shareholder, against Defendants Fund Asset Management, Inc., ("FAM"), Merrill Lynch Asset Management, Inc., ("MLAM"), Merrill Lynch, Pierce, Fenner & Smith Inc. ("Merrill Lynch"), Merrill Lynch & Co., Inc., ("ML") and the Fund. In his amended complaint Krinsk claims in substance that the defendants, in violation of their fiduciary duties, have reaped excessive fee payments from the Fund. He alleges specific violations of §§ 12(b), 15, 20, and 36(b) of the Investment Company Act of 1940 as amended (the "Act"), 15 U.S.C. § 80a-1 *et seq.*, and demands a jury trial.

The defendants have moved to dismiss all of the plaintiff's claims save that under § 36(b). They argue that no private cause of action exists under § 12(b) or § 20 and, further, that since the § 15 claim complains of a fee paid directly by shareholders to Merrill Lynch it is not recoverable in a derivative action and, in any event, fails to state a claim upon which relief may be granted. Defendants also have moved to strike the plaintiff's jury trial demand.

The Parties and Their Relationships

The Fund, it is claimed, is the largest money market fund in existence with assets exceeding $18 billion. Defendant FAM is the investment advisor for the Fund. It is a wholly-owned subsidiary of defendant ML. In exchange for investment advisory and management services provided to the Fund and its shareholders, FAM receives an investment advisory fee that is based on a percentage of the Fund's net assets.

Defendant Merrill Lynch, another subsidiary of ML, is a securities broker which, since September 1, 1983, has provided distribution and shareholder services to the Fund and its shareholders in exchange for a distribution fee that is also based on a percentage of the Fund's net assets.

Merrill Lynch also sponsors something it calls the Cash Management Asset Program ("CMA Program"). The CMA Program links together three components to offer "integrated financial services" to participants. Each member is entitled to (a) a securities margin account, (b) one of three money market fund accounts (the CMA Money Fund, the CMA Government Securities Fund, or the CMA Tax-Exempt Fund) and a federally insured money market deposit account and (c) a Visa card and checking account. Each CMA Program participant then receives a comprehensive monthly statement that details the activity in his account for that month. Each such participant, regardless of whether he is a shareholder in the Fund, is charged an annual $65 fee by Merrill Lynch to participate in the CMA Program.

Claims and Proceedings to Date

Krinsk's original complaint (all of which survived in the amended complaint) alleged that defendants violated §§ 36(b) and 20 of the Act and demanded a jury trial. Its First Claim asserted that FAM and Merrill Lynch charged the Fund excessive advisory and distribution fees, respectively, in violation of their fiduciary duties to the Fund and its shareholders under § 36(b). The Second Claim asserted that on or about July 26, 1984, the defendants caused the Fund to send to its shareholders a materially false and misleading proxy statement for the August 31, 1984 annual meeting of shareholders. Plaintiff claims that this proxy statement identified comparative fees charged by the defendants for services to other funds, and stated that the fee charged to the CMA Money Fund was averaging[1] at approximately .38 per cent of the Fund's asset value, but omitted to state that the fee from the only other fund of comparable size, the Merrill Lynch Ready Assets Trust, was averaging at approximately .34 per cent. The plaintiff also claims that the proxy statement failed to disclose other pertinent facts relating to the defendants' profitability. The complaint alleges that based on the deficient proxy materials, the Fund's shareholders voted to approve the continuance of the existing

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[1] The average is derived by dividing the total asset value into the total fees charged on the various increments of the Fund. This is based on a fee schedule of .5 per cent up to $500 million, .425 per cent for the next $500 million and .375 per cent for assets over $1 billion.

investment advisory agreement and infers that, had there been full disclosure, they would not have done so. By way of relief the original complaint seeks "damages" for these alleged violations of § 36(b) and § 20. Addressing this original complaint, the defendants moved to strike the jury trial demand and to dismiss the Second Claim on the grounds that § 20 of the Act does not create a private right of action in the context of a claim for excessive advisory fees.

While this motion was *sub judice*, the plaintiff filed an amended complaint. He added to the § 36(b) claim an allegation that the service fees (the $65 recurring charge to CMA Program participants) paid to Merrill Lynch were excessive. He also added two further claims for relief under § 12(b) and § 15 of the Act and continued to demand a jury trial as to all claims.

The Third Claim alleges that the defendants violated § 15 of the Act by failing to describe in the investment advisory contract the annual $65 service charge imposed upon each shareholder by Merrill-Lynch for participation in the CMA Program. The Fourth Claim alleges that the defendants violated § 12(b) of the Act because the Fund pays distribution fees to Merrill Lynch and its employees on the basis of the average daily net assets of the Fund instead of whether or not they have sold Fund shares. As to all four claims, Krinsk requests an award of "damages" to the Fund.

Upon the filing of the amended complaint, the defendants promptly moved to dismiss the Third and Fourth Claims. They argue that Krinsk's Third Claim under § 15 challenges a service fee that is paid directly to Merrill

Lynch by each shareholder individually for participation in the CMA Program and not by the Fund, and that, therefore, the claim may not be brought derivatively on behalf of the Fund. Alternatively, they argue that the fee is not compensation for advisory services and thus does not fall within the scope of § 15 requirements for inclusion in the investment advisory contract. They challenge plaintiff's fourth claim under § 12(b) on the grounds that no private right of action exists under that section in the context of this § 36(b) action. They also persist in their contention that no claim asserted by the plaintiff entitles him to a jury trial.

DISCUSSION

I. *Private Causes of Action Under § 20 and § 12(b)*

The question of whether there exists a private right of action under a statute is "basically a matter of statutory construction." *Transamerica Mortgage Advisors, Inc. v. Lewis,* 444 U.S. 11, 15, 100 S.Ct. 242, 245, 62 L.Ed.2d 146 (1979). The Supreme Court in *Cort v. Ash,* 422 U.S. 66, 78, 95 S.Ct. 2080, 2087, 45 L.Ed.2d 26 (1975) outlined four factors to be considered in deciding whether to find a private right of action where none was specifically provided for:

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted," – that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the

> cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

Cort v. Ash, 422 U.S. 66, 78, 95 S.Ct. 2080, 2088, 45 L.Ed.2d 26 (1975). In cases decided since *Cort v. Ash*, the Supreme Court has made it clear that these factors are to be used in order to focus on Congressional intent. *See, Touche Ross & Co. v. Redington*, 442 U.S. 560, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1978); *Transamerica*, 444 U.S. at 23-24, 100 S.Ct. at 249.

Mindful of these basic principles, the Court turns to whether Congress may be held to have intended to authorize private causes of action under § 12(b) and § 20 of the Act in the context of an action for recovery of excessive advisory fees under § 36(b).

The Investment Company Act of 1940
as Amended

Congress enacted the Act to curb preceived abuses in the investment company industry based, in part, upon the lack of arms-length dealing between investment companies and their advisors which provided opportunities for misappropriation of company assets by advisors. The Act's "findings and declaration of policy" includes the statement:

> . . .that the national public interest and the interest of investors are adversely affected . . . when investment companies are . . . operated . . . in the interest of . . . investment advisors . . . or other affiliated persons thereof, [or] in the interest of . . . brokers or dealers . . .

15 U.S.C. § 80a-1.

The Act set up a regulatory scheme under the Securities and Exchange Commission ("SEC") whereby investment company managers are required to manage for the benefit of the investors. For example, the Act requires that at least 40 per cent of the investment company's directors be "disinterested." 15 U.S.C. § 80a-10. Through § 20, the Act controls proxy solicitation. 15 U.S.C. § 80a-20. It also governs contracts between the Fund and both investment advisors and underwriters. *See e.g.* 15 U.S.C. § 80a-15.

For the past quarter century the courts have also permitted private litigants to sue under certain provisions of the Act as a means of affording protection to individual investors and to supplement the SEC's enforcement efforts. In *Brown v. Bullock,* 294 F.2d 415 (2d Cir.1961), Judge Friendly wrote that an aggrieved investor complaining of excessive advisory fees could maintain a suit under § 37 upon a theory of unlawful conversion of the company's assets and under § 15 to ensure that the required annual evaluation by company directors of the advisory and underwriting contracts be a substantive one. *See also, Moses v. Burgin,* 445 F.2d 369, 373 (1st Cir.), *cert. denied,* 404 U.S. 994, 92 S.Ct. 532, 30 L.Ed.2d 547 (1971); *Taussig v. Wellington Fund, Inc.,* 313 F.2d 472, 476 (3d Cir.1963); *Esplin v. Hirschi,* 402 F.2d 94, 103 (10th Cir.1968), *cert. denied,* 394 U.S. 928, 89 S.Ct. 1194, 22 L.Ed.2d 459 (1969).[2]

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[2] Cases implying private causes of action under provisions of the Act prior to 1980 also include: *Tannenbaum v. Zeller,* 552 F.2d 402, 417 (2d Cir.), *cert. denied,* 434 U.S. 934, 98 S.Ct. 421, 54

(Continued on following page)

In 1970, following a period of explosive growth in the investment company industry, Congress enacted comprehensive amendments to the Act. Among these, a new § 36(b) addressed the problem of compensating those who provided services to the investment company where the providers enjoyed a close relationship to the company, through affiliation or overlapping directors, such as would tend to eliminate arms-length bargaining over the fees being charged.

Section 36(b) created a fiduciary duty from the investment advisor and its affiliates to the investment company with respect to the former's receipt of compensation. It authorized a suit to enforce that duty both by the SEC and by a security holder derivatively on behalf of the investment company. In determining whether the the advisor has breached its fiduciary duty, the court is to consider all forms of compensation, including fees received from shareholders as well as "fall out" benefits (e.g. related accounts and use of the "float"). *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923 (2d Cir.1982). Section 36(b) contains specific limitations in subsection (3). "Damages" may only be recovered from the entity to whom the compensation was paid; in no event may they exceed the amount of such compensation; and such damages are not recoverable for a period earlier than the year preceeding the filing of the complaint.

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L.Ed.2d 293 (1977); *Levitt v. Johnson*, 334 F.2d 815, 819 (1st Cir.1964), *cert. denied*, 379 U.S. 961, 85 S.Ct. 649, 13 L.Ed.2d 556 (1965); *Cogan v. Johnston*, 162 F.Supp. 907, 909 (S.D.N.Y.1958) (Edelstein, J.) (denying motion to dismiss).

Congressional purpose in creating § 36(b) and the explicit enforcement mechanism of § 36(b) requires the Court to consider to what extent this provision provides an exclusive remedy where payment of excessive fees is alleged. The statute itself is silent on the point as is its contemporaneous legislative history.[3] However, nothing therein purports to undo the private rights of action that courts had previously found to exist prior to 1970 or to limit the creation of future ones.

To be sure, recent Supreme Court decisions have eschewed the creation of new private rights of action under the securities laws. *Transamerica Mortgage Investors, Inc. v. Lewis,* 444 U.S. 11, 100 S.Ct. 242, 62 L.Ed.2d 146 (1979) (§ 206 of the Investment Advisors Act); *Touche Ross v. Redington,* 442 U.S. 560, 99 S.Ct. 2479, 61 L.Ed.2d 82 (1979) (§ 17(a) of the Securities and Exchange Act). However it does not appear that these decisions have jeopardized implied private rights that have been previously established, *See Herman & MacLean v. Huddleston,* 459 U.S. 375, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983), including one under § 20 of the Act tacitly recognized in *Galfand v. Chestnutt Corp.,* 545 F.2d 807, 813 (2d Cir.1976).[4]

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[3] This Court rejects any argument that the Act's jurisdictional section, § 44 creates private rights of action. *See, Touche Ross v. Reddington,* 442 U.S. 560, 577, 99 S.Ct. 2479, 2489, 61 L.Ed.2d 82 (1979) (discussing § 27 of the Securities Exchange Act of 1934).

[4] The House Report accompanying the 1980 amendments to the Act states that "Congress has long taken the view that private rights of action for violations of the federal securities

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In *Fogel v. Chestnutt*, 668 F.2d 100 (2d Cir.1981) (Friendly, J.) the Court of Appeals upheld a fund investor's right to sue fund directors affiliated with the investment advisor for breach of their fiduciary duty to inform disinterested directors of material information. The court reached this result despite the fact that the defendants' actions were motivated by a desire to increase advisory fees. Judge Friendly, after considering *Transamerica, supra*, noted that the Supreme Court had not negated an implied private right of action under the Investment Company Act and stated that "we do not think § 36(b) was intended to negate implied causes of action which the courts have found under sections of the Act other than § 36." *Fogel*, 668 F.2d at 111. *See also, Tannenbaum v. Zeller*, 552 F.2d 402, 417 (2d Cir.1977). However, Judge Friendly remarked:

> We might agree with defendants that § 36(b), with the severe limitations of subsection (3), constitutes the exclusive remedy insofar as a private claim alleges solely that compensation of an advisor subsequent to . . . the effective date of § 36(b), is so excessive in the sense of surpassing any reasonable relation to the services rendered that its payment is a breach of fiduciary duty.

Id. at p. 112.

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laws are a necessary adjunct to the Commission's enforcement efforts." H.R.Rep. No. 96-1341, 96th Cong., 2d Sess. 28, reprinted in 1980 U.S. Code Cong. & Ad. News 4800, 4810. While such language is too general to be taken as supporting the creation of any specific right of action, it does support the conclusion that Congress has acquiesced in private rights previously found. The report goes on to encourage the creation of private rights of action under the 1980 legislation which is not at issue here.

From the foregoing, this Court must conclude that, at least in the Second Circuit, a private right of action may exist under the Investment Company Act independent of § 36(b) even where excessive advisory fees are implicated in the non-§ 36(b) claim, except where such claim amounts to nothing more than a claim for recoupment of excessive compensation such as Congress intended to be brought under § 36(b). Put another way, a plaintiff may not escape the strictures of § 36(b)(3), by merely characterizing his § 36(b) claim as arising under a different section.

(a) *A Private Right of Action Under § 20*

Although the plaintiff's § 20 claim is closely related to his assertion that fees paid to FAM are excessive, it goes further. Its essence is that the defendants misled the shareholders who voted to approve the advisory agreement by omitting material facts from the proxy statement. The underlying character of the § 36(b) and § 20 claims is different and the facts that plaintiff must prove to show a violation of § 20 are distinct from the facts needed to prove a violation of § 36(b). Further, the ills sought to be remedied differ as between § 36(b) and § 20. The latter is directed to the need by those voting on management issues, including advisory agreements, for accurate and adequate information with which to make informed decisions; the former addresses the particular problem of compensation agreements in the non-disinterested context of the advisory relationship.

Finally, there is every indication in the legislative history that Congress wished the system for proxy

regulation under § 20 to parallel that under § 14 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78n. The Senate Report states:

> to assure uniformity of interpretation and administration as between that act [the Securities Exchange Act of 1934] and the present bill, § 20(a) of the bill has been so drafted as to follow verbatim § 14(a) of the Securities Exchange Act, with only slight modifications of language as are necessary because of the special classes of companies to which § 20(a) applies.

S.Rep. No. 76-1175, 76th Cong., 3d Sess. 17 (1940). For nearly a quarter century, implied causes of action have been permitted under § 14(a) of the Securities and Exchange Act of 1934. *J.I. Case Co. et al. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964). Under such circumstances, to deny a private right of action under § 20 would frustrate a long-standing regulatory scheme in the proxy area in which SEC enforcement is supplemented by private suits.[5]

The defendants argue that *Gartenberg v. Merrill Lynch Asset Mgt., Inc.*, 528 F.Supp. 1038 (S.D.N.Y.1981), aff'd 694 F.2d 923 (2d Cir.1982), cert. denied, 461 U.S. 906, 103 S.Ct. 1877, 76 L.Ed.2d 808 (1983) ("*Gartenberg I*"), forecloses a private right of action under § 20. In *Gartenberg I*, Judge Pollack dismissed a § 20 claim raised by one of the two plaintiffs after the trial as "lacking merit, not asserted and not proved." However, he briefly addressed the § 20 claim on the merits "for the sake of completeness" and

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[5] Rule 20a-1, 17 C.F.R. 270.201-1, promulgated by the SEC § 20, specifically incorporates the regulations and standards of § 14(a) of the 1934 Act and the rules thereunder.

concluded that the alleged omission was not material and that in any event § 20 does not establish a private right of action in the context of a claim to recover excessive advisory fees. *Gartenberg I*, 528 F.Supp. at 1067. In affirming this decision, the Court of Appeals did not specifically address the private right of action question but rather concluded that the dismissal of the § 20 claims were justified as "not having been presented to the district court for adjudication" and that in any case, for the reasons stated by the district court "they are meritless." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 934 (2d Cir.1982).

The *Gartenberg I* District Court's comment eschewing a private right of action under § 20 was dicta. Moreover, in *Gartenberg v. Merrill Lynch Asset Management Inc.*, 573 F.Supp. 1293 (S.D.N.Y.1983) ("*Gartenberg II*") the same judge decided a § 20 claims on the merits. Thus it is clear not only that Judge Pollack did not ground his decision in *Gartenberg I* on the lack of a § 20 private right action, but also that a § 20 claim may be asserted together with a claim under § 36(b).

This Court's view of how the § 20 private right of action fared in the *Gartenberg* litigation is shared by Judge Ward. In *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 622 F.Supp. 169 (S.D.N.Y.1985), after carefully evaluating the legislative history of Section 36(b), the *Gartenberg* opinions, and the purposes of § 20, he concluded that a private suite may be asserted under § 20 even in the context of a claim for relief under § 36(b). He remarked that,

> particularly where, as here, the challenged claim involves alleged violations of the SEC's

> proxy rules, it would be imprudent and unrealistic to view § 36(b) as a substitute for the implied right of action previously recognized by the Second Circuit under § 20(a). Both the terms of the statute and the case law interpreting it demonstrate that § 36(b) was not designed to provide redress to mutual fund shareholders for material misstatements in or omissions from proxy statements.

Id. at 177. *Compare, Tarlov v. Paine Webber Cashfund, Inc.*, 559 F.Supp. 429 (D.Conn.1983). *But see Kamen v. Kemper Financial Services, Inc.*, 85 Civ. 4587 (N.D.Ill., E.D., 2/2/87) [Available on WESTLAW, DCTU database].

Accordingly, this Court denies defendants' motion to dismiss the plaintiff's claim under § 20.

(b) *A Private Right of Action Under Section 12(b)*

Unlike plaintiff's § 20 claim, his claim under § 12(b)[6] is indistinguishable from his § 36(b) claim. The plaintiff alleges that by calculating Merrill Lynch's distribution fee as a percentage of the assets in the Fund regardless of the number, if any, of securities sold, the defendants have violated Rule 12b-1. The essence of plaintiff's § 12(b)

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[6] Section 12(b) prohibits an investment company from acting as a distributor of its own securities unless it complies with regulations promulgated thereunder by the SEC. Rule 12(6)-1, 17 C.F.R. 270.12(b)-1, defines the circumstances in which an investment company may act as an underwriter of its own securities and regulates distribution plans entered into between investment companies and underwriters. Under Rule 12b-1, the investment company directors are held to the fiduciary standards of § 36 when they consider whether to impliment or continue a distribution plan.

claim appears to be that the fee should have been related in some way to the sales themselves and that the failure to do this resulted in an excessive fee to Merrill Lynch. This is the type of claim covered by § 36(b) and, indeed, plaintiff recognized as much by including the distribution fee claim as part of his § 36(b) action. Further common identity of the claims under § 36(b) and § 12(b), where the core question is excessiveness of the fees, appears from the fact that § 36(b)'s fiduciary duty standard is explicitly referenced in Rule 12b-1.

There appears to be no basis for holding that Congress intended a private right of action under § 12(b) in a fee case such as this, where the plaintiff has been expressly granted an adequate remedy under § 36(b). Accordingly, since plaintiff's distribution fee claim lies under § 36(b), he may not evade the limitations of § 36(b)(3) by bringing the same claim under § 12(b). The Fourth Claim under § 12(b) is accordingly dismissed.

This Court need not decide whether § 12(b) would afford a private remedy in a context other than where plaintiff has a remedy under § 36(b).[7] The Court holds only that a plaintiff may not circumvent the procedural limitations of § 36(b), by dressing an identical claim for relief in the language of § 12(b).[8]

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[7] See *Meyer v. Oppenheimer Management Corp.*, 764 F.2d 76, 85 (2d Cir.1985) noting that "a substantial question arises whether a private right of action exists for any violation of the Rule or any violation of a plan approved pursuant to the Rule."

[8] The Court also notes that the plaintiff tacked on his claim for relief under § 12(b) as a late addition in an apparent

(Continued on following page)

II. *The Derivative § 15 Claim*

Section 15 of the Act provides that an investment advisor may service an investment company only pursuant to a written contract in which the terms of compensation are precisely set forth. In his Third Claim for relief, plaintiff alleges that the defendants violated this provision since the contract between FAM and the Fund does not set forth that Merrill Lynch, the Fund's distributor, unilaterally charges each shareholder $65 per year as a members of the CMA program. Plaintiff has brought this claim derivatively, on behalf of the Fund, and seeks recovery, by way of restitution, of the service charge into the Fund.

The $65 annual service charge by Merrill Lynch is not confined to Fund shareholders, rather it is levied on *all* CMA Program participants, whether or not they are invested in the Fund, and it covers the servicing of that participation including the opening and maintenance of the various accounts and preparation and furnishing of the comprehensive monthly statement. In no respect is it compensation paid by the Fund for services rendered to the Fund.

(Continued from previous page)

attempt to circumvent the rule in this circuit that § 36(b) does not entitle a plaintiff to a jury trial. Although it is not necessary to decide the issue, the Court can discern no basis for concluding that the jury issue here would be decided differently under § 12(b) than under § 36(b) where both claims seek equitable restitution.

Plaintiff's claim under § 15 belongs not to the Fund, but to the shareholders. It is they who, the plaintiff alleges, have been wrongfully caused to pay the service fee. The Fund has no claim with respect to fees paid by its shareholders. This claim, therefore, is not the appropriate subject of a derivative action.

In an effort to skirt this difficulty, plaintiff argues that the Court should equate the shareholders with the Fund, aggregate shareholder claims under § 15 and convert them into a claim of the Fund. This argument is meritless. In the first place, plaintiff requests the Court to discard the traditional distinction between derivative and individual causes of action, but has pointed to no authority supporting such a result. Moreover, even if the Court were to somehow equate the shareholders and the Fund for purposes of determining liability, the Court could not award the Fund damages belonging to its shareholders. Hence, plaintiff has not stated a cause of action upon which relief can be granted.[9]

A similar situation leading to a similar result was presented in *Cohen v. Fund Asset Management, Inc.*, [1980 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶98,433 (S.D.N.Y.1980). In *Cohen* the plaintiff fund shareholder

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[9] If payment of the $65 fee has caused the investment advisor or distributor to receive compensation in breach of its fiduciary duty, the plaintiff has a remedy under § 36. That section of the Act expressly directs the Court to include fees paid by shareholders in examining the propriety of the remuneration to the advisor or distributor. The plaintiff has indicated his awareness of as much by amending his § 36(b) claim to include the $65 fee.

claimed an excessive sales charge in a derivative suit. The Court concluded that:

> Since the sales charges flow directly from the investor to the distributor or securities dealer, it is the investor who is the proper party to assert this action, not the Fund, nor the plaintiff shareholder on behalf of the Fund.

Id. at pp. 92571-72. The plaintiff's attempt to distinguish *Cohen* on the grounds that it dealt with a single payment by investors, rather than a recurring fee, is unpersuasive. No matter how often the shareholders pay the charge, it is they, and not the Fund, that lose $65 with each payment, and they, not the Fund, are the proper recipients of damages caused by those fees. Plaintiff's claim under § 15 is accordingly dismissed.

III. *Jury Trial*

The Seventh Amendment "requires trial by jury in actions unheard of at common law, provided that the action involves rights and remedies of the sort traditionally enforced in an action at law, rather than in an action in equity or admiralty." *Pernell v. Southall Realty,* 416 U.S. 363, 375, 94 S.Ct. 1723, 1729, 40 L.Ed.2d 198 (1974). The question in this case is whether the plaintiff has stated claims under § 36(b) and § 20 which sound in equity or at law.

(a) *Section 36*

The Second Circuit Court of Appeal's opinion in *In Re Gartenberg,* 636 F.2d 16 (2d Cir.1980) forecloses the plaintiff's right to a jury trial of his claim under § 36(b).

That decision affirmed Judge Pollack's conclusion in *Gartenberg v. Merrill Lynch Assets Management, Inc.*, 487 F.Supp. 999 (S.D.N.Y.1980) that Congress intended in § 36(b) to create an equitable action for breach of fiduciary duty. The court, however, left open the possibility that, presented with a "bona fide claim" for damages under § 36(b), the outcome might be different.

Latching on to this language, plaintiff here has drafted his § 36(b) claim as one for "damages" rather than an "account" as sought in *Gartenberg I.* But the mere substitution of a word does not change the nature of relief requested. The claim under § 36(b) asserted in this case is indistinguishable from that in *Gartenberg I,* namely, that the defendants have breached their fiduciary duty to the Fund by taking excessive compensation. "If it did, the excessive portion of the fee must be returned." *In Re Gartenberg,* 636 F.2d at 18. Since the § 36(b) claim alleges nothing which would entitle plaintiff to a remedy other than equitable restitution, he is not entitled to a jury trial on the issue.

This view accords with that of the First Circuit, where Judge Breyer, writing in a factually similar case, stated:

> We can find no significant differences of any sort between the two complaints except that one uses the word 'account' while the other uses the word 'damages.' And in our view, the right to a jury trial cannot turn on the simple substitution of a different word.

In re Evangelist, 760 F.2d 27, 31 (1st Cir. 1985). Accordingly, plaintiff is not entitled to a jury trial of his § 36(b) claim.

(b) *Section 20*

Plaintiff also contends that his § 20 claim for damages entitles him to a jury trial. To determine whether this claim sounds in equity or in law, the Court must "examine the nature of the issue to be tried in the light of historic legal and equitable practices applicable to issues of a similar nature." *In Re Gartenberg,* 636 F.2d at 18; *See also, Maldonado v. Flynn,* 477 F.Supp. 1007 (S.D.N.Y.1979) (J. Weinfeld).

The nature of relief available to redress a violation of proxy regulations depends upon the circumstances in which the violation occurred. In *Maldonado* Judge Weinfeld was asked to uphold a jury trial demand where the alleged proxy misrepresentations resulted in a tainted election of directors. He drew a distinction between cases involving financial deals where an "investor is cashing in on his investment or changing its essential nature," and other corporate actions, such as elections, and concluded that "pecuniary damages do not, as a matter of course, flow from an improper election." *Maldonado,* 477 F.Supp. at 1009-10. After assessing the nature of the plaintiff's claims for damages in light of the alleged violation, he concluded that "in the event plaintiff prevails, it is clear that to the extent it is established that the corporation was damaged, restitution would be the remedy." *Id.,* at 1011.

In the instant case, this Court concludes that a proxy misrepresentation that results in the continuation of a contract for advisory fees, like one resulting in a tainted election of directors, would lead to equitable relief, such

as an order to hold a new shareholders vote upon corrected proxy materials, recission or reformation of the agreement and restitution of excessive fees. The plaintiff has alleged no facts which could reasonably entitle him to damages at law. Accordingly, the defendants' motion to strike plaintiff's jury trial demand as to the § 20 claim is granted.

CONCLUSION

For the reasons stated above, the Court dismisses plaintiff's claims under §§ 12 and 15 of the Investment Company Act of 1940 and strikes plaintiff's demand for a jury trial as to the remaining claims.

SO ORDERED.

[¶ 93,812] Krinsk v. Fund Asset Management, Inc.

United States District Court, Southern District of New York. No. 85 Civ. 8428. June 27, 1988. Opinion in full text.

Investment Company Act – Advisory Fees – Fiduciary Duty. – A fund shareholder's claim that the fund paid excessive advisory fees was rejected since there was no breach of fiduciary duty under Section 36(b) of the Act. In the context of a fund embedded in a central asset account, it was found that shareholders received "high caliber" services, that the fund was within normal and acceptable industry ranges as to both expenses and fees, that the 12b-1 plan was neither improperly adopted nor implemented, and that the trustees were qualified and well-informed in their deliberations approving both the advisory fee and the 12b-1 plan.

See ¶ 49,806, "Investment Companies – Reports; Records; Liabilities" division, Volume 5.

Investment Company Act – Advisory Fees – 12b-1 Plans. – Fees paid by a mutual fund under its Rule 12b-1 plan can be considered by the trustees and the court in determining the appropriateness of the advisory fee under Section 36(b) of the Act. To the extent that the 12b-1 fees are excessive for the purpose intended, they should be considered with the advisory fee to determine if payment of the two, in combination, amounts to a breach of fiduciary duty by the trustees under 36(b).

See ¶ 48,162, "Investment Companies – Affiliates; Functions; Directors" division; and ¶ 49,806, "Investment

Companies - Reports; Records; Liabilities" division, Volume 5.

Investment Company Act - Advisory Fees - 12b-1 Plans. - In considering fees paid under a 12b-1 plan in the context of fiduciary duty in payment of advisory fees, the use of 12b-1 payments to encourage better shareholder service and maintain fund size does not violate Rule 12b-1. Payments to consultants to halt out-flow of assets and improve shareholder service are consistent with the rule's definition of "distribution" so long as the primary intent is to increase the fund's size. Fund shareholders benefit by improved service resulting from 12b-1 payments and may also benefit by the recruitment and retention of better management personnel who may be attracted to a larger fund.

See ¶ 48,162, "Investment Companies - Affiliates; Functions; Directors" division; and ¶ 49,806, "Investment Companies - Reports; Records; Liabilities" division, Volume 5.

Investment Companies - Proxies - Advisory Fees. - A mutual fund's failure to disclose that the fee of a fund of comparable size averaged approximately .34% of the asset value was not a material omission since the funds were significantly different in that the one was a standalone fund while the other was a component of a central asset account. In addition, they were not competing for the same customers.

See ¶ 48,681, "Investment Companies - Capital; Proxies; Securities" division, Volume 5.

Opinion of WALKER, District Judge.

INTRODUCTION

Plaintiff Jeffrey Krinsk brought this derivative action on behalf of the CMA Money Fund ("Fund"), under the Investment Company Act of 1940, as amended, 15 U.S.C. § 80a-1 *et seq.* (the "Act"), to recoup allegedly excessive advisory fees paid by the Fund to its investment advisor. Defendants are Fund Asset Management, Inc. ("FAMI"), Merrill Lynch Asset Management Inc. ("MLAM"), Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPFS"), Merrill Lynch & Co., Inc. (collectively, "Merrill Lynch"), and the Fund. At all times relevant to this action, plaintiff has been a shareholder of the Fund.

Krinsk commenced this action on May 16, 1985,[1] seeking initially to recover for the Fund all investment advisor compensation determined to be excessive for the period January 1, 1980 to May 16, 1985. On May 1, 1986, this Court held that the one year statute of limitations in § 36(b) of the Act restricts plaintiff's claim to recoupment of fees paid to the investment advisor after May 17, 1984. *Krinsk v. Fund Asset Management Inc.*, Slip Op. 85 Civ. 8428 (JMW) (May 1, 1986).

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[1] This is not the first action to challenge as excessive the fees received by Merrill Lynch for managing the Fund. Two previous lawsuits challenged as excessive the Fund's advisory and distribution fees for the years 1979 to 1984 under § 36(b) of the Act. *See Rosenfeld v. Merrill Lynch Asset Management, Inc., et al.*, 80 Civ. 6122 (TPG) (S.D.N.Y. filed October 28, 1980); *Kalman v. CMA Money Fund, et al.*, 81 Civ. 2574 (TPG) (S.D.N.Y. filed March 10, 1981). Plaintiffs in those actions voluntarily dismissed those actions.

Plaintiff's first amended complaint alleged that the defendants had violated §§ 12(b), 15, 20 and 36(b) of the Act. On March 4, 1987, this Court dismissed the §§ 12(b) and 15 claims and struck plaintiff's demand for a jury trial. *Krinsk v. Fund Asset Management, Inc.*, 654 F.Supp. 1227 (S.D.N.Y. 1987). At the subsequent bench trial, beginning March 16, 1987, the Court heard evidence on plaintiff's remaining claims: (1) that for the period May 17, 1984 to December 31, 1986, fees were paid to the investment advisor in violation of the advisor's fiduciary duty under § 36(b); and (2) that the 1984 Fund proxy statement distributed to CMA Fund shareholders by the defendants contained materially misleading statements.

The Court has carefully appraised the testimony of the witnesses in the context of their demeanor, interests and expertise, examined the numerous documents received in evidence and conducted a word-by-word review of the trial transcript. For the reasons stated below, the Court finds for defendants on both claims and dismisses the complaint. This opinion constitutes the Court's findings of fact and conclusions of law pursuant to Fed. R. Civ. P. 52.

I. *Background*

A. *The CMA Program*

The Fund is one component of a financial services package offered by Merrill Lynch called the Cash Management Account program ("CMA program"). Since, as all parties agree, the Fund must be considered in the context of the CMA program as a whole, it is necessary to explain that program and its operation in some detail.

The CMA program links together (1) a traditional securities brokerage account (the "securities" or "margin" account); (2) a savings vehicle consisting of one of three money market funds (one of which is the Fund) or an insured savings account; (3) a VISA debit card; (4) check-writing privileges; and (5) a comprehensive monthly statement. Merrill Lynch requires each incoming CMA participant to invest $20,000 in cash and/or securities; however, the participant need not maintain a minimum balance.

Merrill Lynch introduced the CMA program in 1977. From 1977 through 1986 the number of CMA participants grew from 34,792 to over one million. Although Merrill Lynch was the first to offer such a product, generically known as a central assert account, today many of the firm's competitors offer similar products.

The parties agree that the focal point of the CMA program is the securities account. T. 452 (Zeikel).[2] Through it, CMA participants may purchase or sell securities on "margin" (credit) or with cash. Although Merrill Lynch offers no discount brokerage rates as part of the CMA program, individuals may negotiate with Merrill Lynch for redutions in the price of their transactions on the basis of the value of their securities business. T. 755-6 (Zeikel); 890-92 (Walsh).

CMA participants are an important source of commission revenue to Merrill Lynch. CMA securities

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[2] References to "T" are to the trial transcript; names to witnesses; Dept. to deposition; Px. and Dx. to exhibits of plaintiff and defendants, respectively.

accounts generate an average of $1,200 in commissions per year, while other Merrill Lynch securities accounts produce on average only $400 in commissions per year. T. 990 (White); Px. 26. As of December 31, 1986, the CMA brokerage accounts constituted one-fourth of all Merrill Lynch brokerage accounts, yet produced approximately one-half of Merrill Lynch's brokerage commission revenues.

A significant component of the CMA program is the primary savings vehicle or mony account. In selecting a savings vehicle, the CMA participant chooses either one of three money market funds – the CMA Money Fund, the CMA Government Securities Fund, the CMA Tax-Exempt Fund – or the Insured Savings Account, a money market deposit account opened by Merrill Lynch on behalf of the participant at one or more banks or savings and loan institutions. Px. 75c. A participant is free to switch his designation of the primary savings vehicle at any time, and at any time may hold shares in more than one CMA savings vehicle.

The CMA program links the securities account to the primary savings vehicle through a "sweep" feature. Uninvested cash or "free credit balances" generated in the securities account through, for instance, payment of dividends or sale of securities, are swept automatically into the money account. Px. 2, 4, 6, 75a. When a participant's free credit balance is $1,000 or more, it is swept that day for investment the following day. Balances less than $1,000 are swept weekly.

The subject of this lawsuit, the CMA Money Func, is a no-load, diversified, open-ended investment company

registered under the Act. As of January 5, 1987, assets invested in the Fund exceeded $19 billion, making the Fund the largest money market mutual funbd registered under the Act. T. 511 (Zeikel); Dx. A. Approximately 75% of Merrill Lynch's CMA participants hold assets in the CMA Money Fund.

The Fund seeks the current income and preservation of capital and liquidity available from investing in a diversified portfolio of short-term money market securities. Fund dividends are declared and reinvested daily in the form of additional shares, each worth about $1. The participant's investment in the Fund is represented by the number of shares he holds. A shareholder may redeem or purchase additional shares in any amount without incurring a transaction charge.

The VISA debit card and check-writing privileges are tied to the savings vehicle and securities account. These components of the CMA program provide Fund shareholders with immediate access to money deposited in the Fund and to margin credit. With each VISA card use, the shaerholder's account is debited immediately after the transaction clears. The time between the date of transactjon and date of clearing is approximately five days, during which time the shareholder has interest-free use of his or her money. T. 889 (Walsh). VISA transactions are handled through the Merrill Lynch Bank and Trust Co., a banking subsidiary of Merrill Lynch. Since the CMA program links the VISA card to the securities account as well as to the primary money account, the VISA cards may be used for larger purchases on margin.

The check-writing privileges are offered through Bank One, Columbus Ohio, which clears the checks the looks to MLPFS for payment. In 1986 MLPFS processed 54,855,708 checks, an average of four per month per shareholder. Dx. C. These checks averaged $745 in amount. T. 69 (Livingstone).

When a customer's check or VISA transaction clears, Merrill Lynch pays the debt first out of any free credit balance, then out of the Fund or any other savings vehicle and, finally, from the available margin loan value of securities in the customer's account, the total of these comprising the authorization limit for check or VISA transactions. Px. 75. Interest charged on margin loans is based upon the "broker call rate", the rate at which brokers can borrow and lend.

Merrill Lynch sends each CMA participant a comprehensive monthly statement, containing both a summary of the account balances, investment income earned, and account activity,[3] and more detailed information about securities account holdings and CMA account activity during the month.[4] Due to their length and detail, the

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[3] The summary identifies the shareholder's cash holdings, CMA Money Fund balance, balance of any other money funds, priced investments, the margin loan value of securities and the shareholder's authorization limit, investment income earned during the month and for the year to date, account activity during the month and the average rate of return of the Fund.

[4] Included is information regarding securities and options bought or sold, whether on margin or paid for; any other type of transaction in the securities account; daily activity in the

(Continued on following page)

monthly statements takes MLPFS one week to print. CMA participants also receive a year-end tax statement summarizing their taxable activities over the year.

B. *Merrill Lynch & Co. and its Affiliates*

MLAM and FAMI provide the management services and MLPFS provides the shareholder services necessary to support the CMA program. FAMI is a wholly-owned subsidiary of MLAM which in turn is a wholly-owned subsidiary of Merrill Lynch. Both FAMI and MLAM are registered as investment advisors under the Act.[5]

MLAM is investment advisor to between 40 and 50 mutual funds as well as institutional and individual investors. T. 450 (Zeikel). The Merrill Lynch Ready Assets Trust ("RAT") is among the funds that receive investment advisory services from MLAM. MLAM manages approximately $82 billion, $32-$36 billion of which is held in money market accounts such as the RAT and the CMA Money Fund.

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CMA money accounts and securities accounts; each VISA and check transaction with the check number or the location of the VISA transaction, the date of transaction, date of clearance, amount and payee.

[5] MLAM actually provides the advisory services. Since FAMI is merely the corporate vehicle with whom the Fund contracted for services, the Court will refer to the investment advisor collectively as MLAM.

MLAM's management services to the Fund include: (1) general administrative services, such as supervision of financial and accounting matters and tax compliance; (2) fund organizational services such as preparation of materials for director and shareholder meetings; and (3) portfolio management in compliance with the Fund's investment objectives and legal requirements. In managing the Fund's portfolio, MLAM has access to the research work of the MLPFS Security Research Division and Merrill Lynch Economics, Inc. Dx. 18.

MLPFS, a subsidiary of Merrill Lynch and the largest securities firm in the United States, services the individual CMA accounts. *Id.* MLPFS is responsible for processing new accounts, VISA and checking services, for printing and distributing the monthly statement, and for responding to customer inquiries.[6] It also provides the sophisticated computer system linking the various components of the CMA program.

The point of contact between MLPFS and the CMA program participant is the MLPFS account executive, denominated a "financial consultant," of whom MLPFS has 11,000. Patrick Walsh, manager of the Merrill Lynch Asset Accumulation Group, described the financial consultant's role at Merrill Lynch as "basically to satisfy the needs of his clients and to provide his clients with financial advice and information regarding trading and helping his client with his finances." T. 869. From Merrill

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[6] MLPFS is a broker in securities, options contracts, commodities and financial futures contracts, and selected insurance products. It is a dealer in options and corporate and municipal securities. MLPFS is also an investment banker.

Lynch's perspective, the financial consultant's principal function is to effect securities transactions on which MLPFS earns commissions. In turn, MLPFS compensates the financial consultants by paying commissions on these transactions, whether for CMA customers or non-CMA customers. In addition, financial consultants receive .11% of the Fund Assets under their supervision, pursuant to a "12b-1" plan, discussed below. Financial consultants are assisted by sales assistants.

C. *Fees paid by the Fund and its Shareholders*

As compensation for the services of MLAM and MLPFS, the Fund and its shareholders pay three fees: an annual service fee paid to MLPFS by all CMA program participants; the investment advisory fee paid by the Fund to MLAM; and payments made by the Fund to MLPFS pursuant to a 12b-1 plan, nearly all of which is passed on to the financial consultants.

1. *The Service Fee*

Merrill Lynch charges an annual fee to each CMA program participant, including those who have chosen savings vehicles other than the CMA Money Fund. The fee appears on the CMA program monthly statement and is paid on the anniversary of the participant's entrance to the program by a cash debit or by selling fund shares.

The fee rose from $20 at the program's inception in 1977, to $50 in 1984, and then $65 in December 1985, its current level. Walsh testified that the fee was raised to $65 upon his recommendation, and that he advocated the

change because "with all the resources and all of the commitments we had made to the account, our account at that was one of the lowest priced in the market place, and we just decided that we should get up to where everyone else was as far as the fees were concerned. . . ." T. 948. The Fund's Trustees played no role in the decision to raise the program fee in 1985.

2. *The Adivisory Fee*

The Fund pays a percentage of the total assets in the Fund as an advisory fee to its investment advisor, MLAM, according to the following schedule:

> .50% up to $500 million of average net assets (50 basis points)[7];
>
> .425% in excess of $500 million but not exceeding $1 billion of average net assets (42.5 basis points);
>
> .375% in excess of $1 billion of average net assets (37.5 basis points).

Amounts paid by the Fund under the advisory agreements for the years ending December 31, 1984-86 were:

	Fee Paid	**effective rate**
1986	68,996,608	.38
1985	63,939,204	.38
1984	52,934,492	.38

Dx. A. The Fund Trustees and Fund shareholders approve the fee on an annual basis.

The fee scale has remained unchanged since October 11, 1979 when the Fund's assets totalled $605 million.

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[7] A "basis point" equals .01%.

From June 1983, when the Fund stood at approximately $12 billion in assets, until March 1986, when the Fund was at about $18 billion, the effective fee rate decreased less than one-fourth of a basis point - .0023%[8] Px. 17.

3. *The 12b-1 Payments*

Since September 1, 1983, the Fund has paid .125% of the Fund's assets (12.5 basis points) to MLPFS for distributing Fund shares. These 12b-1 payments are remitted to MLPFS pursuant to a Distribution Agreement and a Shareholder Servicing and Distribution Plan ("12b-1 plan").[9] As noted above, under the 12b-1 plan MLPFS passes through 11 basis points to the financial consultants. MLPFS pays 1 basis point to sales management, and up to .50 of a basis point is kept by MLPFS to offset administrative costs of the program. T. 602-03 (Zeikel); White Dep. 52-53.[10]

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[8] From September 1979 to June 1981, as Fund assets increased from $605 million to $7 billion, the effective advisory fee rate dropped from .4869 to .3867. Since then, due to an ever-increasing proportion of assets generating a fee rate of .375, little change in the effective advisory fee rate has occurred.

[9] Pursuant to Rule 12b-1, 17 CFR § 270.12b-1 (1987), promulgated under the Act, the trustees of a registered open-end management investment company may adopt a written plan for use of fund assets in distribution of fund shares. The plan, and any agreement with any person relating to implementation of the plan must be adopted in conformance with the standards outlined by the Securities and Exchange Commission in Rule 12b-1. The Rule is discussed in greater detail, *infra* at § III.F.

[10] The financial consultants receive an average of $3,000 in 12b-1 payments each year. This constitutes approximately 3% of their total commission income.

D. *The Trustees*

1. *Information Available to the Trustees*

The Fund is governed formally by a Board of Trustees (the "Board" or the "Trustees") consisting of Messrs. Zeikel, Colgan, Forbes, White, O'Reilly, Lenagh, and West, of whom only Zeikel is formally affiliated with Merrill Lynch, as a vice-president. The unaffiliated Trustees, who have their own, separate counsel, comprise the Fund's Audit Committee and nominating Committee. T. 1334 (West).

The Board's principal responsibility is to evaluate the advisory fee annually and the 12b-1 plan quarterly in light of the interests of the shareholders. The Board also oversees the investments and administration of the Fund. T. 515 (Zeikel). The Board meets regularly four times a year and at special meetings. *Id.* at 516. The day-to-day management of the Fund is left to MLAM.

In Audit Committee meetings, held immediately prior to full Board meetings, the unaffiliated Trustees review matters relevant to fund administration, such as the 12b-1, plan and the fund's portfolio management. Zeikel, the only affiliated Trustee, is occasionally invited to attend or make presentations at Audit Committee meetings, as are other Merrill Lynch personnel. *See* T. 1336-37 (West).

All six unaffiliated Trustees joined the Board at Merrill Lynch's invitation.[11] All serve on other Merrill Lynch

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[11] The shareholders, of course, voted their approval of the Board members. Members coming onto the Board after the inception of the Fund also received approval from the other Board members.

fund boards. Each receives total compensation from Merrill Lynch in a range from $50,000-86,000 annually for board service. *See e.g.*, T. 404 (Colgan); T. 1332 (West); T. 1489 (Forbes).

In order to aid the Trustees in their deliverations, the Merrill Lunch organization provides them with extensive information, including memoranda relevant to the advisory and distribution agreements. In 1984, for example, the unaffiliated Trustees received a "Green Book", Px. 15, which discussed, *inter alia,* the role of the unaffiliated Trustees, litigation affecting the Money Fund, FAMI and MLPFS management and distribution proposals and alternatives to those proposals, and a legal analysis of the reasonableness of management compensation, with discussion of both *Gartenberg I* and *Gartenberg II.*[12] The 1984 Green Brook also included lengthy memoranda on the advisory agreement and the 12b-1 plan.[13] In 1985 and 1986, the Trustees received Green Books with even more detailed information. Px. 16, 17. All three Green Books contained informational exhibits relevant to Trustee deliberations. *See* T. 1340 (West).

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[12] *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 528 F. Supp. 1038 (S.D.N.Y. 1981), *aff'd* 694 F.2d 923 (2d Cir. 1983) (*Gartenberg I*); *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 573 F. Supp. 1293 (S.D.N.Y. 1983), *aff'd* 740 F.2d 190 (2d Cir. 1984) (*Gartenberg II*).

[13] The Green Book also referred to profitability studies presented to the Trustees at full board meetings (the studies were appended as exhibits to the 1984 and 1985 Green Books);

(Continued on following page)

In 1985 and 1986, counsel to Merrill Lynch prepared a Directors Manual and sent it to all Merrill Lynch fund trustees, including the Trustees of the Fund. Px. 18, 19. Each Manual included an exhaustive memorandum describing the factors to be considered by the Trustees in evaluating investment advisory fees, an extensive presentation of the legal requirements of Rule 12b-1 and information concerning 12b-1 plans adopted by the MLAM-sponsored funds. It also included the trial and appellate court opinions in the *Gartenberg* litigation. Additionally, the Manual informed the Trustees about the structure of the MLAM organization and MLAM's services to Merrill Lynch money market fund shareholders, as well as other Trustee responsibilities such as selection of independent accountants.

Prior to each full Board meeting, the Trustees also received from Merrill Lynch a "preliminary agenda" for the full meeting which frequently contained additional

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included a profitability statement of MLAM, exclusive of the revenues and expenses of other Merrill Lynch affiliates such as MLPFS; provided comparative information about advisory agreements of other funds, such as information on advisory fees, expense ratios and performance of other funds; summarized performance data; and contained operating expense information. It also included information about 12b-1 plan, such as a description of the plan, a breakdown of the ways in which Merrill Lynch spent the payments, its impact on the expense ratio, total income and yield, and comparative tables on other funds with 12b-1 plans. Information necessary to other required Trustee approvals was also presented. The Green Book was prepared by Brown and Wood, counsel to The Fund.

information relevant to Trustee consideration of the investment advisory fee and 12b-1 plan.[14] *See e.g.* Dx. BF.

The Trustees received other periodic memoranda from the Fund and Merrill Lynch counsel updating them on legal developments in the investment company field. T. 1346 (West); Dx. BJ. The Trustees also received the proxy material for their review prior to its distribution to shareholders. T. 1362 (West).

The parties do not dispute, and the Court finds, that the Trustees were fully informed throughout the relevant period as to all matters relevant to any determination for which they were responsible.

2. *Consideration of the Advisory Fee*

In this case, the Trustees reviewed the materials received with regard to the advisory fee in light of the various *Gartenberg I* factors, discussed in detail below. Trustee White credibly explained that the material distributed to the Trustees included "a sort of tick-off sheet of various factors we have to follow." Dep. 17. He remarked that: "[g]enerally what we do in the group is go

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[14] Specifically, the agenda provided a MLAM commentary on the stock market for the period under review and described the trading activity of the Fund's portfolio, average life of the Fund's investments, the Fund's yield, annualized net return, and portfolio structure. It also included comparisons of the Fund's performance with that of other funds and other types of investments, a report on the Fund's transactions during the quarter, a statement of the Fund's operating expenses, assets and liabilities, and a listing of the Fund's size and number of shareholders.

down those, some we can handle reasonably rapidly, some we spend more time discussing, but before we renew the agreement we've gone though every one of those factors." *Id.*

The factors reviewed by the Trustees included: (1) the nature and quality of services rendered to the shareholders by the Merrill Lynch organization; (2) the fees paid by the Fund and payable at projected asset levels, expense ratio and performance of the CMA fund; (3) comparative data on fees, expense ratios and performance of other funds; (4) advisory fees negotiated in the settlement of litigation under § 36(b); (5) the profits to Merrill Lynch directly attributable to the CMA Fund; (6) the wisdom and practicability of assessing "Fall-out" benefits to Merrill Lynch and the hypothetical impact of these fall-outs on Merrill Lynch's profitability[15]; (7) possible economies of scale realized in managing such a large fund; and (8) the entrepreneurial risk to Merrill Lynch and losses incurred on the CMA program during the program's early years.[16]

The Trustees assessed the advisory fee's fairness in relation to the CMA program as a whole rather than in

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[15] Fall-out benefits are non-fee benefits to Merrill Lynch, such as securities revenues and margin interest, which result from Merrill Lynch's sponsorship of the CMA Fund. *See infra* § III.C.

[16] In 1983, the Audit Committee focused heavily on comparative fees in the money market industry. Following *Gartenberg I*, the focus shifted to the profitability of the Fund to Merrill Lynch. *See* Px. 10, 12.

relation to the Fund in isolation. Trustee West testified that,

> the trustees talked at some length among ourselves and with others about what did it mean to talk about profitability, and the more we talked, the more convinced we all became that it really had to be looked at in the context of the profitability of this thing called the CMA program or product, that trying to pull out a piece of it and look at it as though it were a standalone piece, was trying to unscramble an omelet.

T. 1350; *see also* Lenagh Dep. 63.

West explained that the service fee and advisory fees offset the costs of the program as a whole and "if you can tell me exactly what is paying for what, you're a better man than I." T. 1460. Thus, the Trustees evaluated the fairness of the advisory fee in light of costs and benefits of the CMA program as a whole, not simply MLAM's management of the Fund.

The unaffiliated Trustees concluded throughout the period at issue here that the advisory fee required no "fine-tuning."[17] Px. 10 at 9. On June 13, 1984, June 12, 1985 and June 11, 1986, the Trustees voted unanimously to approve renewals of the investment advisory fee challenged in this action. Dx. AN, Px. 11, Px. 13.

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[17] There is no probative evidence that the Trustees ever considered internalization of advisory services or the retention of an alternative advisor.

In 1984 the Audit Committee concluded that (1) the comparative information "confirmed the general appropriateness of the current fee schedule;" (2) the Peat Marwick & Mitchell ("PMM") full-cost profitability study, which showed overall direct losses for Merrill Lynch on the CMA Fund for the years 1982 and 1983, was the most accurate profitability study to date and provided no current basis for adjustment of the fee; and (3) a causal problem existed in assessing the benefit to Merrill Lynch of fall-out benefits from the Fund. Dx. AM. Despite this last conclusion, committee members were nonetheless furnished with information on all profits earned from securities transactions in CMA securities accounts.[18]

The Audit Committee reached similar conclusions in 1985 and 1986. In 1985,

> [m]embers of the committee concluded that the absence of evidence indicating that substantial economies of scale were realizable in the operation of the CMA program, coupled with the highly variable nature of the CMA program profitability would make it problematic to attempt a "fine-tuning" of the Fund's established advisory compensation arrangements from year to year in a reaction to the CMA Program profitability estimates.

Px. 10. In June 1986, the Audit Committee reviewed a profitability study presented by Alan White, a Merrill Lynch employee, and the next day the full Board approved the advisory agreement. Px. 13.

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[18] These overall benefits to Merrill Lynch stood at about $105 million in both 1982 and 1983, according to the PMM study, representing a return on revenue of 12.5% and 9.2% respectively. Dx. AM.

E. *The 12b-1 Plan*

1. *Adoption of the Plan*

In March 1983, concerned by the erosion of Fund assets,[19] T. 1446-47 (West), T. 409 (Colgan), MLAM suggested the adoption of a 12b-1 plan to implement a sales incentive program, and provide the Trustees with a memorandum, prepared jointly by counsel for MLAM and the Fund, explaining Rule 12b-1 and the legal and financial considerations to be taken into account before adopting a 12b-1 plan. Dx. AW, AX. The Trustees rejected at least two 12b-1 plan proposals. On May 9, 1983, the Trustees received the 1983 Green Book which set forth information relevant to a decision whether to adopt the proposal in effect today.[20] Px. 14. This 12b-1 plan obligates the Fund to pay MLPFS .125% of its assets and requires MLPFS to channel the money to the financial consultants and managerial staff, as compensation "for selling [Fund shares] and for providing direct personal services to shareholders, including furnishing information as to the status

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[19] This erosion was part of a general trend of decreasing money market and brokerage account assets, which began after passage if the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1349 (1982), permitting banks and savings and loan institutions to offer money market accounts and central asset accounts. *See e.g.* T. 589-91 (Zeikel).

[20] The Green Book contained, *inter alia,* a description of the proposal, the requirements of Rule 12b-1, a comparative study from Lipper-Directors' Analytical Data on 12b-1 plans adopted by other funds as of November 18, 1982, the impact of the sales plan on the expense ratio, total income and yield of the Fund, a brief description of the reasons why MLAM suggested the plan, and director responsibilities in adopting it.

of Fund accounts and handling purchase and redemption orders for Fund shares." Px. 17 at 523. The plan, one of the least expensive 12b-1 plans in effect,[21] prohibits the use of the distribution fee to pay for other expenditures of MLPFS related to the Fund, such as sales contests, special seminars, or media advertising,[22] provides for quarterly reports to the Trustees, requires annual approval by both the full Board and the unaffiliated Trustees and is terminable at any time by a majority vote of the unaffiliated Trustees. Dx. AY at 10-11; Px. 17 at 523-6.

Approval of the plan followed formal Trustee consideration of the factors listed in SEC Investment Company Act. Release No. 11,414[23] and was based on practical

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[21] The Trustees had rejected a plan incorporating an 18 basis point fee as to expensive in comparasion with competitors' fees. As reported by Lipper Analytical Securities Corporation, of the 415 mutual funds with 12b-1 plans, the Fund's fee is the fourteenth lowest. Dx. J-1.

[22] Previously the Trustees had rejected as inappropriate a proposal permitting the 12b-1 funds to be used for these purposes.

[23] The Commission has suggested that the following factors are normally relevant to a decision to adopt a 12b-1 plan;

(1) the need for independent counsel or experts to assist the directors in reaching a determination;

(2) the nature of the problems or circumstances which purportedly make implementation or continuation of such a plan necessary or appropriate;

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concerns, such as, with the substantial recent erosion of Fund assets, that the Trustees and Merrill Lynch wanted financial consultants to induce CMA customers to place increased cash deposits in the Fund. The 12b-1 plan was an incentive program designed both to halt the outflow the Fund assets and to increase the size of the Fund. T. 1246 (West); T. 595-97 (Zeikel); T. 409 (Colgan); T. 920 (Walsh).

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(3) the causes of such problems or circumstances;

(4) the way in which the plan would address these problems or circumstances and how it would be expected to resolve or alleviate them, including the nature and approximate amount of the expenditures; the relationship of such expenditures to the overall cost structure of the fund; the nature of the anticipated benefits, and the time it would take for those benefits to be achieved;

(5) the merits of possible alternative plans;

(6) The interrelationship between the plan and the activities of any other person who finances or has financed distribution of the company's shares, including whether any payments by the company to such other person are made in such a manner as to constitute the indirect financing of distribution by the company;

(7) the possible benefits of the plan to any other person relative to those expected to inure to the company;

(8) the effect of the plan on existing shareholders; and

(9) in the case of a decision on whether to continue a plan, whether the plan has in fact produced the anticipated benefits for the company and its shareholders.

Investment Company Act Release No. 11414 (October 28, 1980).

The Trustees were especially concerned with promoting the CMA program as a whole. Trustee Lenagh frankly stated: "I am more concerned about the CMA program than I am about the CMA money fund, in that the account executives are stimulated to sign up, maintain and service the CMA program and not the money fund per se." Dep. 34. Formal minutes of the Audit Committee also reflect a concern for the entire program. *See* Dx. AM.

In addition to their concern for the entire program, the Trustees believed that a larger Fund has advantages over smaller funds in the marketplace. The Trustees believe that bigger funds generally produce higher rates of return and that a decline in fund assets inhibits fund performance since a manager must then focus on liquidity needed to satisfy redemptions, rather than on investments that can increase yield. Zeikel explained, "[i]f one has a fully invested position and a new opportunity arises, then one can take advantage of it with the cash flow. If there is negative cash flow, one has to reduce the portfolio commitment to pay off the cash flow and then reduce it again to take advantage of the new commitment." T. 705. *See also* T. 1428-29 (West).

A secondary goal of the 12b-1 plan was to improve financial consultant services to shareholders. Barely mentioned at the time of the plan's adoption[24] this purpose assumed greater importance in the Trustees' subsequent deliberations.

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[24] Indeed the Audit Committee and full Board minutes of May 19, 1983, reflect no consideration by the Trustees of shareholder servicing. *See* Px. 9. The text of the plan, however, states

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In 1983, the Trustees engaged no expert in connection with their consideration of adoption of the 12b-1 plan. In concluding that a large and growing fund was desirable, they relied upon the "casual empiricism" available to them as trustees of a very big fund and upon conversations with Merrill Lynch portfolio managers. *See* T. 1428 (West); White Dep. 30; Lenagh Dep. 26.

While the Trustees may have considered other methods of encouraging Fund growth and halting the exit of Fund assets than through a 12b-1 plan, *see* Px. 8 at 4, Trustee discussion centered upon "alternatives in the sense of variations of the plan." T. 1424 (West). The Trustees also considered such possible intangible benefits to Merrill Lynch as a lower turnover rate for financial consultants. T. 1425-26 (West).

All these deliberations led the Trustees to favor adoption of a 12b-1 plan. The Audit Committee believed the Plan could reduce redemptions and retain fund assets "in the face of competition from banks and other money funds." Px. 8. Despite the difficulties in assessing sales incentive programs, the Trustees believed that "failure to meet the[se] competitive threats [posed by other funds

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that the payments are to compensate the financial consultants for the services they provide shareholders, and the Proxy Statement sent to shareholders states that Merrill Lynch, at least, reasonably believed this would occur. In addition, Zeikel and Colgan also refer to shareholder servicing as part of the initial considerations of the Trustees. T. 597, 604 (Zeikel); T. 415 (Colgan). Forbes testified that encouraging a flow of assets to the Fund was of great concern to the Trustees. T. 1492-93. *See also* T. 609 (Zeikel).

The Court finds that, in 1983, the Trustees focused their attention on the diminishing size of the Fund. Shareholder servicing was a secondary consideration.

with 12b-1 plans] could result in substantial diminution of the Fund assets with concomitant increase in the expense ratio." *Id.* The effect of the plan on expense ratio and yield caused them no concern and they agreed that the pass-through feature of the plan meant Merrill Lynch profitability was not increased by the plan. They concluded "that the plan offered a reasonable prospect of significant benefits to the Fund and its shareholders and that the costs of the plan in relation to such benefits appeared reasonable." *Id.* At the full Board meeting on May 19, 1983, the Trustees adopted the plan.[25] Px. 9.

On June 10, 1983, Merrill Lynch described the 12b-1 plan approved by the trustees in a proxy statement to shareholders. Dx. AY. The statement explained the terms of the plan, set out the Trustees' considerations, and included information on the effect of the plan on the expense ratio and yield, and information on comparative expense ratios and yields. The plan, approved by a majority of shareholders on July 26, 1983, went into effect on September 1, 1983.

2. *Continuation of the Plan*

The Trustees have reviewed the plan each quarter since it went into effect. As required by Rule 12b-1, Merrill Lynch relayed pertinent information to the Trustees, in the form of a 12b-1 report, prior to Audit

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[25] As required by Rule 12b-1, the entire Board approved the plan and the unaffiliated Trustees approved it separately.

Committee meetings.[26] The annual Green Book contained additional data.[27] In their review, the Trustees also discussed the plan with Fund portfolio managers, who described to the Trustees the advantages of managing a large and growing fund. T. 1429-30 (West).

Patrick Walsh ordinarily presented the 12b-1 report to the Audit Committee and added "anecdotal" information on the financial consultant response to the 12b-1 plan and the quality of service provided by the financial consultants to the shareholders. T. 1494 (Forbes). He opined, based on conversations with regional branch personnel, that "the 12b-1 plan was having a highly salutary effect in improving service provided to CMA shareholders and in proving a more positive attitude on the part of account executives with respect to the CMA program," Dx. AM., and that "12b-1 compensation made the financial consultants more receptive to dealing with Fund shareholder inquiries." Px. 12.

Although as of the trial there had been little research on the desirability of a growing fund, and none of it conclusive, the Trustees' belief therein had been strengthened, in part, by the views of portfolio managers, by

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[26] The Trustees were informed of MLPFS's disbursement of 12b-1 payments, the volume of CMA complaints, and the number of CMA account openings and closings. In the yearly Green Book, they received additional data, such as the effect of the payments on expense ratio and yield. They also received comparative information on other funds.

[27] *See supra* fn. 13, fn. 20.

enthusiastic financial consultants, and by the Fund's strong yield.[28]

The Trustees are convinced that the 12b-1 plan will keep the Fund growing and healthy. They view payments to the financial consultants as an effective means to encourage a strong financial consultant-CMA client relationship, an important concern given their perception of increasing competition in the money market and central asset account markets. Trustee Colgan stated that if the plan were to be discontinued "it would result in a diminution of interest on the part of the account executives and salesmen." Dep. 418. Such diminution of interest would derogate from Merrill lynch's ultimate goal of "keeping [its] clients in a positive frame of mind as far as the CMA Money Trust is concerned." T. 919 (Walsh). However, although they view the plan as a success, the Trustees are aware that it is impossible to be certain how well the plan is actually working. *See e.g.* T. 1435 (West).

Following quarterly reviews of the factors listed in Investment Company Act Release No. 11,414, the Trustees have repeatedly approved the plan's continuation.

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[28] In 1986, Trustee Forbes described to the Trustees a study undertaken by Anthony Beavers, a graduate student at State University of New York at Albany, which confirmed their view that a positive correlation between fund size and net return exists. T. 1494-97. Zeikel credibly testified that studies showing a link between size and performance "reinforce[d] a view that [he] built out of [his] own experience." T. 635-37. Trustee Forbes was cross-examined at length as to a prior study he had co-authored that suggested the opposite conclusion. T. 1505-21.

II. *The Law*

Section 36(b) of the Investment Company Act of 1940[29] places a "fiduciary duty" on an investment advisor with respect to receipt of payments from a registered investment company. This standard was fully explicated by Judge Mansfield in *Gartenberg I*, F.2d at 923, 927-928.[30]

While a plaintiff bears the burden of proving a breach of the investment advisor's fiduciary duty under § 36(b), a plaintiff is not required to show personal misconduct on the part of the advisor, nor must the plaintiff meet the standard required to hold a fiduciary liable for corporate waste. *Id.* However, a district court is not empowered "to substitute its business judgment for that of a mutual fund's board of directors in the area of management fees." *Id.* at 928, quoting S. Rep. No. 91-184, 91st Cong., 1st Sess., *reprinted in* [1970] U.S. Code Cong. & Ad. News 4897, 4902-03 [hereinafter, the "Senate Report"].

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[29] Section 36(b) provides in relevant part that:

"The investment advisor of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services or payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment advisor or any affiliated person of such investment advisor."

[30] *See also Gartenberg II; Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 663 F. Supp. 962 (S.D.N.Y. 1980) *aff'd* 835 F.2d 45 (2d Cir. 1987), *cert. denied* 56 U.S.L.W. 3753 (May 2, 1988).

Further, the legislative history to § 36(b) makes clear that the advisor is entitled to earn a profit from his services and that his fees need not be determined by "general concepts of rate regulation, such as those applicable to public utilities." Senate Report at 4902; *Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 663 F. Supp. 962, 972 (S.D.N.Y. 1980), *aff'd* 835 F.2d 45 (2d Cir. 1987), *cert. denied* 56 U.S.L.W. 3753 (May 2, 1988).

Gartenberg I capsulized as follows the test for determining whether an advisor has breached its fiduciary duty: "essentially whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in light of all the surrounding circumstances" and not "so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." 694 F.2d at 928.

In determining the reasonableness of the advisory fee, Congress "intended that the court look at all the facts in connection with the determination and receipt of such compensation, including all services rendered to the fund, its shareholders and all compensation and payments received. . . ." Senate Report at 4910, quoted in *Gartenberg I*, 694 F.2d at 930.

In particular, the court in *Gartenberg I* suggested the importance of such factors as (1) "the expertise of the individual trustees of a fund, whether they are fully informed about all facts bearing on the adviser-manager's services and fee, and the extent of care and conscientiousness with which they perform their duties;" (2)

the nature and quality of services provided to fund shareholders; (3) the advisor's cost in providing these services; (4) economies of scale realized by the advisor as the fund grows larger; and (5) the volume of orders that must be processed by the fund's advisor. *Gartenberg I,* 694 F.2d at 930; *Schuyt,* 663 F. Supp. at 972-973. The *Gartenberg I* court also suggested that, while comparisons with other industry advisory fees may be helpful, since compensation among advisors for fund business "is virtually non-existent, . . . [r]eliance on prevailing industry advisory fees will not satisfy § 36(b)." 694 F.2d at 929.

This suit differs from those brought in this Court under § 36(b) on prior occasions. For the first time, the Court is presented with a challenge to fees paid by a fund embedded in a central asset account. As noted earlier, all parties agree that the fund cannot be viewed separately from the other programs components. While the Court agrees with this view, it is also mindful that the issue before it is whether Merrill Lynch, and specifically MLAM, breached its fiduciary duty to the Fund alone in its receipt of the advisory fee.

The Court concludes that the location of the Fund within the CMA program is a "surrounding circumstance" which would pervade as aspects of a hypothetical arm's-length negotiation over the Fund's advisory fee. This fact is relevant to important considerations such as costs and benefits of the fund to Merrill Lynch and services received and costs incurred by Fund shareholders.

III. *Findings and Conclusions as to the § 36(b) Claims*

Introduction – The Fund as a Component of the CMA Program

The CMA program, of which the Fund is a major component, provides advantages both to Merrill Lynch and to the shareholders. The shareholders benefit from the automatic sweep, the associated VISA debit card and check writing privileges and the comprehensive statement. Merrill Lynch benefits by maintaining under its roof and within the control of each financial consultant a greater share of the client's total assets. The uninvested portion of these assets is close at hand, available for investment. Thus the Court is not surprised that CMA participants generate three times the commission revenue of the non-CMA brokerage customer and that financial consultants are encouraged to prospect among Fund shareholders for commissionable transactions.

The degree to which the Fund's presence within the CMA program enhances Merrill Lynch's profitability from retail securities transactions was not established at trial. That some profit results seems self-evident and the Court has no hesitation in so finding. With this as background, the Court examines each of the factors set forth in *Gartenberg I* to evaluate the reasonableness of the compensation to the advisor and its affiliates in light of the fiduciary standards articulated in that decision.

A. *Nature and Quality of Services Provided to Shareholders*

Services to the Fund are provided by MLAM and MLPFS. MLAM's management services include portfolio

management and general administrative and organizational services. MLPFS provides shareholder-related services for both the Fund and the CMA program.

1. *MLAM's Services*

Plaintiff does not dispute the high quality of the general administrative and organizational services MLAM provides to the Fund. No evidence was presented indicating that such services, including legal compliance with regulatory requirements, management of relationships with auditors and bank custodian and transfer agents, provision of office space, equipment and personnel and preparation of material for Trustee and shareholder review, were other than fully satisfactory.

With regard to the quality of MLAM's portfolio management services, the parties are in sharp dispute. Merrill Lynch points to the fact that under MLAM's stewardship, the fund's yield has consistently performed at or near the top of money market funds, whether or not such funds are part of central asset accounts.[31]

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[31] As reported in Donoghue's in 1984 the Fund's average yield was 10.55, in 1985 it was 8.12, and in 1986 it was 6.54. Dx. E-2, F-2, G-2. Over a three year period it earned an average yield of 8.40. Among all taxable retail money market domestic prime funds, its rank for 1984 was second out of 69, in 1985 it was second out of 73 and for 1986 it was ninth out of 73. Dx. H-2. Over the three year period it ranked third of 56. *Id.* Among all taxable retail money market funds, it was eighth of 174 in 1984, ninth of 152 in 1985 and twenty-first of 158 in 1986, ranking tenth of 129 over the three years. Dx. E-1, F-1, G-1, H-1. In relation to other money market funds associated with central asset accounts, it was first of nine in 1984, second of

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Plaintiff challenges these results by contending that the Fund's performance is below average when measured on a "risk-adjusted" basis. Plaintiff's expert Dr. Larry Selden compared mean return with weekly yield fluctuations of 104 money market funds. He found that the Fund had a higher degree of volatility or "risk" than the average fund and that once the return was adjusted downward to reflect the higher risk, the fund's performance was below average.[32] Tr. 284-301; Px. 67A, 67B, 68A, 68B, 68C.

Selden admitted that neither the SEC nor the money market industry adopted "risk adjusted performance" as an industry standard. T. 388. *See also* T. 567 (Zeikel). The Court is unwilling to impose on defendants a performance standard yet to be accepted by the regulatory

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nine in 1985 and fourth of nine in 1986, for a three year ranking of second of nine. Dx. E-3, F-3, G-3, H-3. Thus, in comparison to other funds, the CMA money fund has been a consistently high performer.

[32] Selden compared the volatility of 104 funds reported in *Donoghue's* from March 30, 1983 to December 31, 1986, by taking the standard deviation (a statistic which calculates deviations from the average) of their yields from week to week. He found that the CMA Money Fund's volatility was "roughly 25 per cent higher than the broad Donoghue average." T. 289. To determine "risk-adjusted return," Selden contrasted risk or valatility with yield by dividing the standard deviation for each fund into each fund's mean return. Calculated in this manner, the Fund's risk-adjusted return stood below the average of the 104 money funds. Selden repeated this analysis with a group of nine large funds, including the CMA Money Fund, to ensure that this result was not skewed by the size of the Fund. Among these, the Fund exhibited the lowest return on a risk-adjusted basis.

authority overseeing investment company practices and thus rejects the concept of "risk-adjusted" return as a standard of fund performance measurement in this case.

Further, the yield fluctuations may be explained, at least in part, by the accounting method the Fund uses to report yield. The fund "marks to market" all securities with a maturity of more than 60 days, meaning that the Fund's accounts reflect the current market value of these securities, a number which fluctuates daily according to the factors driving the market. Other funds use a variety of accounting methods: many amortize the difference between present value and value at maturity of an instrument over the life of the investment; others mark-to-market all or part of their fees. In short, the variety of accounting methods used, together with the varying effect of these methods on weekly yield fluctuations, tends to undermine Selden's comparisons of risk-adjusted performance.

Defendants do not argue that risk-adjusted performance, properly calculated to account for the different accounting methods, would be irrelevant to future Trustee deliberation over the Fund's fee and the Court does not so find. If a portfolio with greater volatility should be expected to earn a greater return to justify the investor's bearing that risk, then risk adjustment to the return would be appropriate. It appears possible to perform the appropriate calculations and the Trustees may wish to consider doing so to aid in future deliberations over the Fund's advisory fee.

The Court is satisfied that to the extent the Fund has enjoyed yield results superior to those of other funds, it is

not happenstance. The portfolio manager Joseph Monagle was provided with the extensive research facilities of MLPFS which assess both the economy as a whole and individual securities. The Court credits Monagle's testimony that he trades aggressively[33] with a view to maximizing yield after closely monitoring a host of relevant market factors such as interest rates, Federal Reserve statements and indices, government releases on the economy, fiscal and monetary policy, prices of gold and oil, relative strength of the dollar and market-affecting remarks by government and business leaders. T. 816-17. In addition to market factors, Monagle's testimony clearly evidenced portfolio manager consideration of the credit risk of securities being considered for purchase, the average maturity of Fund investments and projected levels of purchases and redemptions by Fund shareholders.

In sum, the Court concludes that the Fund's performance has been superior and, while it is proper for the Trustees to consider performance on a risk-adjusted basis, plaintiff has failed to establish the Fund's inferior performance, given the Fund's use of the "mark-to-market" method and the lack of acceptance in the industry of risk-adjusted return as a measure of performance. Moreover, the Court finds no fault in MLAM's portfolio management and methods.

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[33] Monagle trades between 6.9 to 22.4% of the portfolio on average each day. Dx. D. Although Monagle is an active trader, the Fund portfolio is confined to a class of relatively conservative investments consisting of United States Treasury and agency obligations and short term paper issued by U.S.-domiciled corporations.

2. *Shareholder Services*

Fund shareholders are provided with an array of superior services and benefits by MLPFS, derived from MLPFS's field force of 11,000 financial consultants and sales assistants, and its extensive computer capability.

MLPFS supplied the services linking the Fund to the rest of the program. The MLPFS computer processes and records all financial activity in program accounts, including securities transactions, Fund purchases and redemptions, VISA and check transactions, and account openings and closings, and processes and prints the CMA monthly statement that MLPFS mails to participants.

Shareholders receive personal customer service through MLPFS's network of financial consultants, one of whom is assigned to each customer opening a CMA account. Aided by sales assistants, the financial consultants provide investment advice and respond to customer queries on all aspects of the CMA program, including the Fund.

The Court concludes that MLPFS provides CMA Money Fund shareholders with a broad range of high-quality services. Shareholders reap benefits from MLPFS directly, as members in the Fund, and indirectly, because the Fund is part of the CMA Program. Direct benefits include personal attention to customer inquiries regarding the Fund, and VISA and checking services. Indirect benefits include the sweep feature that ensures that cash does not remain idle, association of the Fund with the margin account, which enables shareholders to make purchases on margin with their VISA cards and checks, the monthly statement, which simplifies record keeping, and

additional attention paid to shareholders by financial consultants because they are members of a program which generates substantial commission revenue.

In sum, the Court finds the nature and quality of services received by Fund shareholders to be of the highest order.

B. *Profitability to Merrill Lynch from the Fund*

Gartenberg I mandates consideration of the Fund's profitability to Merrill Lynch, a task made more formidable by the Fund's location within the CMA program. Defendants contend that Merrill Lynch loses money on the Fund, while plaintiff claims that the Fund, in the context of the CMA program, is highly profitable to Merrill Lynch.

To differentiate between the Fund and the rest of the program, the parties have drawn a distinction, adopted by the Court, between, "fee based" and "non-fee based" costs and revenues. The fee based side of the CMA program includes the Fund, the VISA card and the checking privileges. T. 1054 (Peppet). The non-fee based side consists of the securities and margin accounts. The principle accounting disputes arise over the proper allocation of costs between the fee based and non-fee based sides. Of course, to the extent that greater costs are allocated to the fee based side of the program, the Fund's profitability to Merrill Lynch is reduced.

At the outset, the Court recognizes the impossibility of arriving at an exact profitability figure. *Cf. Schuyt*, 663 F. Supp. at 978 wherein this Court "acknowledge[d] that

it is left in this case with the problem of uncertain profitability." Calculation and allocation of costs against different product lines or, in this case, among different segments of the same product, is an art rather than a science. Little certainty exists in this field where different, albeit rational, methodologies lead to widely disparate results. *See Id.* at 977-78. Hence, the Court must be satisfied with a common sense range of figures within the Fund's profitability to Merrill Lynch most likely falls.

Three profitability studies are before the Court. In 1986, H. Allan White, director of finance for Merrill Lynch's consumer market sector, conducted an internal study of CMA program profitability for 1985. A year later, at Merrill Lynch's request and in preparation for this litigation, Peat Marwick & Mitchell ("PMM") completed a study for the years 1984-1986. PMM partner Russell F. Peppet directed the effort and testified at trial for the defendants. Finally, at plaintiff's request, Professor John Wesley Livingstone of Babson College analyzed the White and PMM studies and drew his own conclusions as to profitability. These three studies, each with its own weaknesses and strengths, estimated fee based pre-tax profits or losses (and profitability as a percent of total fee revenues) as follows (numbers are in thousands):[34]

[34] Pre-tax profits = Total fee based revenues, including float minus fee-based expenses; profitability = pre-tax profits divided by total fee based revenues including float.

	June 1986	1985	1984
Livingstone	55,474 (50%)	72,033 (37%)	47,531 (28.5%)
White	N/A	19,823 (10.8%)	N/A
PMM	(16,243) (-17.5%)	(49,719) (-30.1%)	(77,741) (-55.8%)

See Px. 77B, 77A, AT.

If adjustments to the PMM figures are made to remove the hotly disputed costs of financial consultants and sales assistants from the fee based side of the program, PMM's numbers are:

	June 1986	1985	1984
PMM	22,606 (24.3%)	4,966 (3.1%)	(26,548) (-19.1%)

Although the nature of profitability analysis renders an exact computation of Merrill Lynch profits impossible, it is safe to say that fee based profits fall somewhere in the range between the Livingstone and PMM positions. This range is susceptible of further narrowing after a critical examination of the costs allocations made by PMM and Livingstone.

In considering profitability, the Court is mindful that the Fund's presence in the integrated CMA program enhances Merrill Lynch's ability to garner commission revenue. Fund assets are a pool of liquid assets available for investment in securities, and financial consultants target their securities sales pitches to Fund participants.

Costs within the CMA program must be properly allocated in any profitability study lest the Fund subsidize the costs of Merrill Lynch's commission-generating activities. To avoid this clearly improper result, costs attributable to the program as a whole (which may arise

from more than one aspect of the program, including the Fund) must be allocated between the fee based and non-fee based sides of the program on some rational basis. With a view to better defining the range of probable profitability figures, the Court turns now to a closer examination of particular cost allocations advocated by the parties at trial.

1. *Financial Consultants and Rule 12b-1 Payments*

Financial consultants receive compensation from two sources for their services to the CMA program: commissions from Merrill Lynch for effecting securities transactions for CMA customers, and 12b-1 payments amounting to .11% of the CMA Money Fund assets under their control. Plaintiff argues that 12B-1 payments are fee based revenues to Merrill Lynch, but that the costs of both 12b-1 payments and financial consultants[35] are allocable to the securities or non-fee based side of the CMA program. This treatment, of course, has the effect of greatly enlarging fee based profitability. Not surprisingly, defendants disagree with this accounting approach.

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[35] Also at issue is the appropriate accounting treatment of sales assistant costs. Sales assistants assist the financial consultants in providing services to the CMA program customers and are paid a salary for their services. for the reasons stated below, the Court treats the costs of these services in the same manner as those attributable to the financial consultants.

The Court agrees with defendants that 12b-1 payments are neither a revenue[36] nor an expense to Merrill Lynch. Through Merrill Lynch, the Fund pays these monies to the financial consultants for services to shareholders and for selling Fund shares. MLPFS performs a purely administrative function in receiving and dispensing the payments, for which it is reimbursed 1.5 basis points out of the 12.5 basis point 12b-1 fee. The 12b-1 payments do not appear on any of Merrill Lynch's consolidated financial statements, nor on MLPFS's own statements. T. 1970 (Peppet). The Court accepts Peppet's view that 12b-1 payments have no place in a study of profitability to Merrill Lynch.[37]

Defendants argue that general costs to Merrill Lynch for financial consultant and sales assistant work on the

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[36] The Court is aware that Merrill Lynch benefits by having a larger fund from which to prospect for commissions and financial consultants who are focusing their attention on theh Fund. Plaintiff, however, has failed to quantify these benefits and the Court, therefore, cannot include them in a profitability study beyond noting their probable existence.

[37] Plaintiff argues that 12b-1 payments are revenue to Merrill Lynch but may not be costed against the CMA program because the payments are ineffective in achieving their stated goal – growth of the Fund. The Court rejects this argument. First, plaintiff has failed to demonstrate that the 12b-1 payments have not contributed to the growth of the Fund. Second, the payments are distributed not only to encourage growth but also to stimulate improved shareholder service. Finally, even if the payments were ineffective, the Court remains unpersuaded that these costs are not attributable to the product which causes them to exist. Even Livingstone agreed that, including 12b-1 payments as a fee based cost "is within the realm of reason." T.215.

Fund should be partially attributed to the fee based side of the program. The Court agrees that in theory costs to Merrill Lynch of financial consultant and sales assistant time devoted to fee based activities, net of 12b-1 payments so as to avoid double counting, should be allocated against the fee based side of the CMA program.[38] Although Merrill Lynch pays its financial consultants on the basis of the securities transactions they effect, this does not mean that the time they spend on Fund matters is of no cost to Merrill Lynch or of no benefit to the Fund.[39] Any such costs, net of 12b-1 payments, may be attributable to the fee based side.

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[38] Plaintiff's argument that such time may be costed only against non-fee based revenues, since any financial consultant service to Fund shareholders is motivated solely to enhance commission business, is unpersuasive. Relying upon some theory of underlying or true motivation than already eists. Such a theory could lead to anomolous results due to the inherent difficulty of ascertaining the motive underlying a business decision. Accordingly, the Court rejects plaintiff's attempt to inject motivation into the profitability calculus and accepts Peppet's testimony on this point.

[39] The Court rejects Livingstone's argument that because Merrill Lynch pays financial consultants for selling securities, to charge the Fund with a portion of the expense of paying these commissions is to require the Fund to pay for Merrill Lynch's securities business. The fact that Merrill Lynch chooses to compute payment for financial consultants on the basis of the results they achieve in one area of their work does not mean that that payment does not compensate them for all their activities at Merrill Lynch. The Court is supported in this result by the credible testimony of White and Peppet and the Opinion of Judge Pollack in *Gartenberg II*, 573 F.Supp. at 1310. ("The fact that MLPFS account executives are not remunerated on a

(Continued on following page)

The Court finds, however, that there is a failure of proof as to the quantity of financial consultant and sales assistant costs properly attributable to the Fund. In an effort to quantify the financial consultant costs to the CMA Money Fund,[40] PMM conducted a time study in October 1986 to determine the percentage of financial consultant time spent on fee based activity.[41] *See* T. 1122-40. PMM then allocated this percentage of the entire financial consultant cost pool[42] to the fee based side of the program.

PMM studied 35 out of 480 branch offices, chosen on the basis of size and geographical dispersion. Two PMM representatives spent two or three days at each of the 35 offices observing the financial consultants. During this

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(Continued from previous page)

straight time basis does not mean that the time they devote to MLRAT activities has no value to MLPFS or is uncompensated in the payment received by the account executives.")

[40] White made no attempt to calculate the costs of the sales force because he modeled his study after the earlier PMM analysis of CMA which did not include these costs.

[41] He performed an identical study to determine allocable sales assistant costs.

[42] The pool includes: salaries (²/₃ of the total financial consultant cost pool for 1985), fringe benefits, overtime and supper money, communications, occupancy and equipment rental, brokerage clearing, supplies and postage and market development. The Court notes that PMM found it possible to allocate fringe benefit costs in this case although no such costs were calculated for revenues. In addition, some of the costs in the financial consultant pool appear unrelated to the Fund.

time, PMM representatives periodically asked the financial consultants and sales assistants what they were doing. If the financial consultant or sales assistant was on the phone, the representative would present him with a placard listing various activities. The sales person then pointed to the activity in which he was engaged. The placard listed: CMA (fee based activities and CMA account openings); CMA combined (both fee based and non-fee based activities; such as a securities transaction performed with Fund assets); Other Product/Account; Personal; and General Office Administration. In calculating time spent by financial consultants on the Fund, PMM considered only time spent on CMA fee based activities.

PMM concluded that during the two or three days of the study, the financial consultants observed spent approximately 5.9% of their time on CMA fee based activities and account openings. PMM then applied 5.9% against the financial consultant cost pools for 1984, 1985, and 1986, subtracted the amount of the 12b-1 payments and arrived at what Peppet believed to be a conservative figure for financial consultant cost.[43]

The Court finds the PMM time study to be of little probative value in assigning costs. As Livingstone credibly testified, "the study assumes that conditions in the second half of October, 1986 will prevail throughout the first 6 months of 1986, thoughout all of 1985, and all of 1984 . . . a very slender foundation on which to base such

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[43] To determine fee based sales assistant costs, PMM arrived at a figure of 9.2% of time spent on fee based activities and applied it against the total sales assistant cost pool.

a sweeping assumption." T.96. Moreover, PMM work-papers showed that time spent by financial consultants on CMA fee based activities varied in some offices by as much as 33% within the two days of observation. The Court credits Livingstone's testimony that Peppet's results were speculative. Indeed, Peppet himself conceded that "we can only say . . . that these statistical results relate to the 2 weeks under observation during our sample."[44] T.1139

Accordingly, the Court finds the PMM study to be so seriously flawed, both as to method and as to the speculation of its conclusions, as to be an inappropriate basis upon which to apportion financial consultant and sales assistant costs against the Fund. While the Court must eliminate the amount of these costs from its calculation of a profitability range, the Court makes no finding that assigning some such costs always would be inappropriate, merely that the PMM time study does not permit it in this case.

2. *Monthly Statement, New Account Processing and Marketing Costs*

Briefly reviewing other aspects of the PMM study, the Court finds that PMM charged costs incurred by Merrill Lynch in running the CMA program solely

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[44] Peppet added that in 1984 and 1985 the volume of securities transactions was lower and therefore financial consultants probably spent more time on CMA fee based activities during those years. He thought "logically it seemed to me that, if anything, these were conservative numbers as applied to 1984 and 1985." T.1140

against the Fund, instead of allocating these costs between the fee based and non-fee based sides of the program. For instance, PMM assessed all costs of CMA new account processing, monthly statements and CMA program marketing against the fee based side of the program. The Court perceives no basis for allocating all of these costs against the Fund. On the other hand, a discernible portion of these costs is directly related to the Fund and may be so allocated. While the Court is quite certain that the PMM study over-estimates the amount of these costs attributable to the Fund, plaintiff has failed to demonstrate the extent of such over-estimation.

3. *Float Costs, Systems Excess Capacity, Imputed Income and Wire and Order Costs*

Profitability analysis flaws are not confined to the PMM study. Livingstone's study is also flawed. Livingstone contended at trial that Merrill Lynch incurs float costs as a result of delays in charging VISA and check transactions in excess of available funds (so-called declines and overrides). He argued that delays due to Merrill Lynch's "extraordinary forebearance" when CMA customer write checks or incur Visa charges in excess of available funds. T. 60-64. Specifically, Livingstone testified that, in some cases, a CMA customer's refusal to pay "simply stands and Merrill Lynch doesn't do anything about it," and in others the customer is given time to meet his overdraft. T. 62. Livingstone stated that this procedure is consistent "with treating the customer so well in order to pursue the major business of the CMA program, which is securities." T.63. Thus, Livingstone

argued, float costs should be charged against the non-fee based side of the program.

The Court rejects this argument as speculative. Since decline/override float costs are incurred in the administration of the fee based VISA debit and check-writing components of the CMA program, the Court finds that these costs are appropriately charged against fee based revenues.

Plaintiff also challenges PMM's inclusion in fee based computer systems costs of the cost of excess computer capacity required for the securities business. Livingstone, after noting a memorandum in the PMM workpapers indicating that one of the two computer facilities used to service CMA operations has an excess capacity of 64%, assumed the eistence of excess capacity at the other facility. T. 80-83. Livingstone attributed the need for this excess capacity to the securities business. *Id.* at 83-84.

The Court concludes that plaintiff has failed to show that these facilities have significant excess capacity which has been allocated improperly to the fee based side of the program. First, there is no evidentiary basis for Livinstone's assumption that excess capacity exists at the second facility. White and Peppet credibly testified that no such excess capacity exists. T. 1004-06 (White); T. 1109-10 (Peppet). Second, the Court accepts White's testimony that any excess capacity at the second facility is necessitated by CMA fee based transactions.

Plaintiff also claims that PMM erroneously exclúded from its profitability study $1,750,000 per year of "fringe benefit" income earned by Merrill Lynch. According to Livingstone, the fact that Merrill Lynch waives the annual

$65 CMA program fee for its employees means that the employees who participate in the Fund receive a fringe benefit from the fund on behalf of Merrill Lynch. Livingstone testified that the amount of this fringe benefit should be included as a revenue to Merrill Lynch. T. 46-47.

Peppet and White agreed with Livingstone that it would be appropriate to impute foregone service fees as fringe benefit revenue to Merrill Lynch, but testified that this would require a corresponding allocation of costs to Merrill Lynch for fringe benefits received by CMA program employees. T. 1067-69 (Peppet); T. 978-79 (White). Livingstone agreed that this too would be appropriate.

White testified that he made a rough computation of fringe benefit cost and concluded that fringe benefit cost exceeds fringe benefit revenue to Merrill Lynch. T. 977-81. He excluded both these costs and revenues from his profitability study.

The Court finds White's testimony credible and his approach towards fringe benefit costs and revenues reasonable. Given Livingstone's concurrence that inclusion of fringe benefit costs for CMA program employees is appropriate, the Court excludes from both costs and revenues to Merrill Lynch, Merrill Lynch employee fringe benefits from the CMA program.

Plaintiff further claims that Wire and Order costs are more closely related to the securities side of the CMA program and, therefore, should be costed against the non-fee based side of the program. The Court finds that plaintiff has failed to substantiate this claim. White credibly testified that wire and order services are similar to

those provided by an internal telex system and are used by the CMA program for manual subscriptions and redemptions from the Fund. T. 1010. The Court finds that such services are appropriately costed to the fee based side of the program.

4. *Corporate Overhead*

The method of allocating a portion of Merrill Lynch's indirect overhead costs to the fee based side of the program was hotly disputed at trial. Prior to 1985, Merrill Lynch had not even attempted any such allocation. In 1985, White merely assigned the same percentage of Merrill Lynch's total overhead to total corporate costs – 4.2% – to the costs of the fee based side of the CMA program. T. 1014. The PMM study attempted a much more complex allocation by designating general cost pools relating to capital markets and consumer markets (the CMA program falling into the latter) and attempting to allocate general overhead costs, if possible, wholly to one or the other or, if not, in part to one or the other. Once a pool of general overhead costs was allocated broadly to consumer markets, it was further allocated to specific categories of consumer markets – the CMA program, securities, real estate, insurance and commodities.

Both the White and PMM approaches to overhead allocation were rational, albeit wholly unrelated, methods. While PMM's approach is by far the more sophisticated, plaintiff properly criticized it as leading to wide fluctuations in overhead cost allocation to CMA, due to factors unrelated to the CMA program, such as the

amount of securities business being conducted by Merrill Lynch as a whole and general market conditions.

In each of 1984, 1985 and the first half of 1986, the PMM corporate overhead figures, rounded to the nearest million, of $34 million, $21 million and $10 million ($20 million annualized) greatly exceeded White's 1985 number of about $5 million. Not surprisingly, plaintiff's expert Livingstone favored White's 1985 allocation of 4.2% of total costs, and argued that, for lack of comparable percentages for 1984 and 1986, 4.2% be utilized for those years as well. Since the Court cannot reject either the White approach or the PMM approach as irrational or unprincipled, the Court will consider "true overhead" for the three years to fall somewhere in the range of 4.2% of fee based costs up to the amount of the PMM allocation for that year.[45]

5. *Conclusion as to Profitability*

The average annual profitability for 1984 to 1986 estimated by plaintiff was 40.4% Px.77B. Defendants estimated average profitability for the same period to be -32.7%. Dx. AS. After having reviewed carefully the exhibits and the testimony relating to each of the profitability issues raised at trial, the Court concludes that a true profitability figure for the fee based side of the CMA program was probably less than plaintiff's estimate, but greater than the figure defendants urge. Based upon its

[45] PMM's corporate overhead allocations were 1984 – $33,868,000; 1985 – $20,713,000; to June 30, 1986 – $9,962,000 for a three-year weighted average of $25,737,000.

own consideration of the profitability studies presented, in light of the pertinent testimony which the Court has evaluated, the Court concludes that a true figure for a three-year weighted average of pretax profitability would probably fall in a range from at least a few percentage points greater than 0% to perhaps as much as 33%.

C. *Fall Out Benefits*

Fall-out benefits are indirect profits to Merrill Lynch attributable in some way to the existence of the Fund. Fall-out benefits "to the extent quantifiable, should be taken into account in determining whether the Manager's fee meets the standard of § 36(b)." *Gartenberg I*, 694 F.2d at 932.

In *Gartenberg I*, the fall-out benefits at issue were securities commissions from trades for customers who were also shareholders in the RAT, and float income received between issuance and clearance of checks issued upon redemption of fund shares. The unresolved question in that case was the quantity of such fall-out benefits, particularly securities commissions, that could be said to have been caused by the RAT. The District Court accepted Merrill Lynch's contention that any such benefits could not be quantified. The Court of Appeals rejected this contention, but concluded that the burden rested with the plaintiff to "demonstrate that the benefits were so substantial that they rendered the Manager's fee so disproportionately large as to label its negotiation a 'breach of fiduciary duty' within the meaning of § 36(b)." *Id.* The Court held that plaintiff had failed to carry this burden.

In the instant case, fall-out benefits loosely fall into two categories that the Court denominates primary and secondary. Primary fall-out benefits include (1) commission profits from trades in the CMA program securities account; (2) margin interest; and (3) management fees derived from funds other than the Fund within the CMA program. Secondary fall-out benefits include profits earned by Merrill Lynch products and services outside the program, but sold to Fund customers, such as profits from transactions in real estate, life insurance and tax shelters, as well as profits to Merrill Lynch affiliates who transact with the Fund.

1. *Primary Fall-Out Benefits*

Plaintiff contends that Merrill Lynch derives enormous primary fall-out benefits from the Fund, particularly in the form of securities commissions. Defendants insist, as they did in *Gartenberg I,* that such fall-out benefits attributable to the Fund cannot be quantified, and therefore, are of limited use to the Trustees in determining the advisory fee. I See e.g. T. 1019-21 (White); T. 1045-50 (Peppet). Peppet concluded that it was impossible to devise a technique that could determine which securities transactions would not have occurred "but for" the existence of the Fund. T. 1177-87; 1222-23. *See also* T. 1019 (White). He testified that each technique he considered was flawed in that it could not eliminate the variables influencing customers to transact in non-fee based products or other products outside the CMA program, such as market environment, fiscal policy, and customer demographics, and that it was not possible to isolate from these other factors the Fund's effect on securities profits.

He therefore included as "footnote items" the total income earned by Merrill Lynch from CMA customers engaging in non-fee based activities, but did not attempt to set forth what portion of such income was connected to the Fund.[46]

Like defendants, plaintiff also has failed to quantify the amount of primary fall-out benefits to Merrill Lynch attributable to the Fund. Plaintiff simply purposes that the Court include, as primary fall-out benefits, *all* CMA program non-fee based income to Merrill Lynch, because these profits are integral to the CMA program of which the Fund is a part.[47] This goes too far. There is no reason to believe that a portion of these profits would not have been received in the absence of the CMA program or the Fund. Defendants are correct that to attribute a specific dollar figure to fall-out benefits, whether primary or secondary, requires a calculation of how much non-fee based and non-program profit would not have occurred *but for* the existence of the Fund. There is no such calculation in the record. The Court notes that while Merrill Lynch claimed an inability to tie a specific amount of primary fall-out benefits to the fund, it did provide the Trustees with the total profits within which such benefits presumably exist.

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[46] The Court questions Peppet's inability to derive any meaningful figures on fall-out benefits to Merrill Lynch. It appears to the Court that use of regression analysis in combination with a customer survey, or some other combination of studies could lead to a useful result.

[47] As a fall-back plaintiff has also suggested five 20% increments of primary fall-out benefits attributable to the Fund, without establishing a basis for selecting any particular level.

This apparent impasse as to the amount of fall-out benefits attributable to the Fund need not be resolved for the fall-out benefit factor to play ts rightful role. *Gartenberg I* does not proscribe any particular quantity of fall-out benefits beyond which the fee must be reduced to offset gains therefrom. Rather, the thrust of *Gartenberg I* is that the plaintiff must show that the fall-out benefits are "so substantial" that they rendered the advisory fee "so disproportionately large as to amount to a breach of 'fiduciary duty' in violation of § 36(b)." 694 F.2d at 930. Put another way, fall-out benefits are one of the "surrounding circumstances" in the light of which the Court must apply the test of "whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length. . . ." *Id.* at 928.

In this case, since plaintiff has failed to quantify any primary fall-out benefits, he has necessarily failed to establish that such benefits, taken together with other "surrounding circumstances," render the advisory fee so disporportionately large as to be beyond "the range of what would have been negotiated at arm's-length."

2. *Secondary Fall-Out Benefits*

All parties recognized that Merrill Lynch might also earn profits from transactions by CMA program customers which might have a causal link to the existence of the Fund. However, as with primary benefits, neither side attempted to quantify any such secondary fall-out benefits attributable to either the Fund or the CMA program. Moreover, unlike the primary benefits, no totals of pools

of possible secondary benefits were presented to the Trustees.

Merrill Lynch enjoys fall-out benefits when the Fund purchases securities from another Merrill Lynch affiliate. Principal among these affiliates is Merrill Lynch Government Securities, Inc. ("GSI"), which sells to the Fund a small portion of the Fund's overall purchases. T. 839 (Monagle). For example, GSI, in its fiscal year ending March 31, 1986, sold $5 billion of government securities to the Fund (less than 1/2 of 1% of the amount of the Fund's total transactions) and earned profits thereon of about $12.5 million. Plaintiff did not attempt to prove benefits to Merrill Lynch affiliates as fall-out benefits derived from the Fund. In any event, such profits, at least as to GSI, are quite modest, since GSI, operating under an SEC exemptive order with respect to affiliated transactions, is permitted a spread of only .25% on transactions with the Fund.

As with primary fall-out benefits, plaintiff has advanced no basis for the conclusion that the secondary fall-out benefits were of such magnitude that, when combined with other circumstances, they would place the advisory fees received by the Fund beyond the range of what would have been negotiated at arm's-length.

D. *Economies of Scale*

Plaintiff claims that Merrill Lynch benefits from significant economies of scale in managing the CMA Money Fund. Plaintiff's evidence on this point consists of five exhibits which, using numbers drawn from PMM's profitability study, express fee based expenses as a percentage

of fee based revenues. The exhibits purport to show that this percentage decreased from 1984 to 1986 for most fee based costs and for the total Fund operating expenses to Merrill Lynch. Px. 87-91.

These exhibits are inconclusive. As Zeikel credibly explained, economies of scale "relate to the costs incurred in doing a unit of something," T. 731, and plaintiff's exhibits fail to demonstrate that the per unit cost of Fund transactions, such as VISA purchases, decreases as the number of units increases. In Zeikel's view, one must "try and create a detailed analysis of each element of a transaction surrounding the CMA program, over an extended period of time, over different levels of activity, to determine whether or not there are economies of scale." *Id*. at 731-2.

The Court is persuaded by This testimony and finds that merely because the ratio of fee based expenses to fee based revenues declined at a time when the Fund size grew, that fact does not establish that such a decline was necessarily due to economies of scale.

The Court is also persuaded by Ziekel's testimony that there appear to be few economies of scale in managing the Fund. Although the per unit cost of providing management services directly to the Fund decreases as the Fund grows, the per unit cost of servicing Fund shareholders does not. As Zeikel credibly testified, money fund shareholders tend to transfer money in and out of their funds on a regular basis, and the per unit cost of processing these transactions remains constant regardless of the cost and does not vary with the size of the Fund or the number of accounts. T. 532-35.

The Court finds that plaintiff has not successfully demonstrated on this record that significant economies of scale accrue to Merrill Lynch in providing services to the Fund and its shareholders. At the same time, the Court notes that plaintiff's exhibits show that fee based expenses expressed as a percent of fee based revenues did decrease at a time when the Fund size grew. This suggests that there may be economies of scale of which Merrill Lynch and the Trustees are unaware. Accordingly, the Court's conclusion that plaintiff has a failure of proof on the issue of economies of scale should not be read as a finding that no substantial economies of scale exist, or as indicating that the question does not merit further exploration by the Trustees.

E. *Comparative Expense Ratios and Advisory Fees*

Before commencing its analysis of the Fund's advisory fee in light of fees charged by other funds in the industry, the Court notes that fee comparisons of this Fund to funds that are part of central asset accounts are more relevant than comparisons to stand-alone funds.[48]

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[48] Plaintiff claims that the services provided by the RAT which has a more advantageous advisory fee structure, taken in combination with services provided by a brokerage account, do not differ markedly from services offered by the CMA fund and the CMA program. The Court disagrees. Membership in the program entities the Fund shareholder to many services, such as sweep, a comprehensive monthly statement and unlimited checking, which are unavailable to RAT shareholders who have securities accounts at Merrill Lynch.

Because stand-alone funds differ from central asset account funds in their services to shareholders and in their role as a vehicle for holding a customer's assets, the prices charged for them are not entirely comparable. While the Court has considered expense ratios,[49] and effective fee rates of all money market funds, the Court deems most significant the advisory fees charged by other central asset account funds. Even so, such comparisons have limited value due to the lack of competition among advisers for fund business. *Gartenberg I,* F.2d 929.

1. *Expense Ratio*

The expense ratio is obtained by dividing expenses by fund assets. Compared to both stand-alone and central asset funds, the Fund has one of the lowest expense ratios in the industry.[50] Compared to the nine central asset account funds, the Fund's expense ratio was lowest, and significantly below the average. Dx. M.

2. *Advisory Fee*

The Fund's effective advisory fee is also one of the lowest. At .38%, this fee was eleventh of forty-eight

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[49] The annual service fee of $65 per year is not properly includible in the Fund's expense ratio. The service fee is a program fee paid by all CMA program participants, regardless of whether they hold shares in the fund.

[50] As reported by Lipper American Security Corporation in the winter of 1986, the Fund's expense ratio, excluding the 12b-1 plan, was .430, placing it third of 138 among all retail taxable money market funds. Dx. I-1. With the 12b-1 plan, the Fund's expense ratio was .555, placing it eighth of 138. Dx. L-1.

among retail money market funds with assets of over $500 million, Dx. K-1, and second of nine aong central asset account funds. Dx. K-2. When all other fund effective fee rates are adjusted by hypothesizing $10 billion in assets, the Fund's rate still ranks in the middle range. Dx. BD.

With respect to central asset account funds, while the services offered by such funds are similar,[51] their fee structures vary considerably. The Fund's effective fee rate and expense ratios are among the least costly, but the Fund's fee "break points" are less advantageous than those of several other central asset account funds.[52]

The Court concludes that the Fund has neither the most nor the least advantageous fee available within the universe of central asset account funds or money funds generally – its fee is in the middle range of each category.

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[51] The Fund offers services comparable to those offered by other central asset account funds. Several "premium" funds provide an optional "gold" debit card and travel services and charge a higher services fee to participants who wish to use the gold card. Apart from these premium services, there is little to distinguish the various central asset account funds. Differences the Court does note: most central asset account funds have lower charges on return items, several have more advantageous sweep, and most charge shareholders for issuance of additional checks. A few charge shareholders for checking services if the account balance falls below a stated minimum. *See* Ex. AI and AJ.

[52] At the high end of the fee range are five funds with a flat advisory fee of .5%. One fund has an identical fee structure to that of the Fund. The eight others have either flat rates below the effective fee rate of the Fund, or graduated fees with final break points below the Fund's. *See* Dx. BG.

F. *The $65 CMA Service Fee*

Plaintiff complains that Merrill Lynch "unilaterally imposes an annual service fee upon each shareholder in the Fund," and that Merrill Lynch raised this fee from $50 to $65 in December 1985 without consulting Fund Trustees. Further, plaintiff asserts that "[a]t no time have net yield figures for the Fund published by defendants reflected any reduction for the annual service fee." Plaintiff's proposed findings of fact at ¶17.

First, the Court notes that all CMA participants pay the service fee whether or not they are Fund shareholders. Further, the existence of the fee is fully disclosed to potential CMA program participants. All CMA participants must execute a CMA Agreement whereby they agree to pay the annual service fee. A CMA Program Description is explicity incorporated into the CMA Agreement and advises that

> [t]he Money Accounts have been created for the sole purpose of being component parts of the CMA program and, in view of the service fee, those persons seeking solely to invest cash in a money fund or to deposit cash in a money market deposit account and not to use the special features of the CMA program should consider as a more suitable vehicle other money funds or money market deposit accounts offered directly to the public.

Px. 1 at iii. The Program Description also advises potential CMA program participants that there are other existing money funds with similar investment objectives to the Fund and which offer check-writing privileges. *Id.*

The fee itself is a reasonable means by which to seek to hedge against the entrepreneurial risk incurred in setting up and maintaining the CMA program, especially in light of the intensely competitive market environment.

It was not unreasonable for Merrill Lynch to exclude the services fee from the computation of the Fund's yield. Similarly, it was not unreasonable for the Fund Trustees to fail to reduce the advisory fee or the 12b-1 payments as a result of the December 1985 service fee increase.[53] CMA participants pay the service fee directly to Merrill Lynch, not to the Fund. As noted, the fee is paid for participation in the CMA program, regardless of participation in the Fund. The service fee is used to defer costs of the entire program, not just the costs of the Fund. Further, Zeikel credibly testified that to allocate the $65 fee over the different CMA program segments, while possible in the "conceptual sense," was "from an analytical viewpoint very difficult to do." T. 782. Zeikel also testified that at the time the decision to hike the service fee to $65 was made, the cost of providing the services in the CMA program had increased. *Id.* at 777-79.

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[53] Although the record is unclear as to whether the Trustees were informed of the increase to $65 prior to such increase, the record does establish that subsequent to the increase, "[i]n considering the [1984-85 CMA profitability study], members of the [Audit] Committee also noted that future service fee revenues would increase as a result of the phasing in of the new $65 annual fee." Px. 12 at 6. *See also* T. 1404-05 (West).

G. *Rule 12b-1 Plan Fees*

The fees paid by the fund under its Rule 12b-1 plan are properly the subject of consideration by the Trustees and the Court in determining the appropriateness of the advisory fee under § 36(b). To the extent that the 12b-1 fees are excessive for the purpose intended, they should be considered with the advisory fee to determine whether payment of the two, in combination, amounts to a breach of fiduciary duty by the Trustees under § 36(b).

Rule 12b-1 of the Securities and Exchange Commission, 17 C.F.R. § 270.12b-1 (1987), prohibits an open-ended investment company, such as the Fund, from acting as a distributor of its own shares except under conditions prescribed by the SEC. A Fund is deemed to act as a distributor of its own shares when it "engages directly or indirectly in any activity which is primarily intended to result in the sale of shares issued by such company. . . .*Id.* at § 270.12b-1(a)(2). Any payments made by a fund "in connection with such distribution" must be made pursuant to a written plan approved by a majority of the shareholders, the fund's independent directors and its board. The Rule also provides that a 12b-1 plan may be implemented or continued "only if the directors who vote to approve such implementation or continuation conclude, in the exercise of reasonable judgment and in light of their fiduciary duties under state law and under § 36(a) and (b) (15 U.S.C. 80a-35(a) and (b)) of the Act, that there is a reasonable likelihood that the plan will benefit the company and its shareholders. . . ." *Id.* at § 270.12b-1(e).

Plaintiff, without stating the relief he requests, claims that the Fund trustees adopted and continued the 12b-1 plan in breach of the fiduciary duties established under Rule 12b-1 and § 36(b). The Court presumes that plaintiff seeks a declaration that all or part of the 12b-1 payments is excessive and, to the extent that causes the advisory fee to be excessive, that the latter should be ordered reduced in like amount.

Plaintiff challenges the 12b-1 plan on several grounds: (1) the plan does not benefit the Fund; (2) any benefits of the plan accrue only to Merrill Lynch; (3) the plan was adopted for reasons unauthorized by Rule 12b-1; and (4) the Trustees, who did not attempt to quantify the benefits of the plan to the Fund, did not act independently or reasonably in adopting it. The Court addresses each of these claims separately.

Plaintiff argues that the plan does not serve Fund shareholders because it does not promote Fund growth and, even if it does, larger funds perform no better than smaller funds.

According to Livingstone, 12b-1 payments are an ineffective stimulus to financial consultants to pursue Fund growth because the payments are insignificant in comparison to commissions earned by financial consultants on securities transactions. T. 213-14. In his view, financial consultants have a substantial incentive to convince clients to invest in a securities account and little or no incentive to induce them to place their money in the Fund. *Id.*

Livingstone's testimony that the 12b-1 plan does not promote growth is unpersuasive. The fact that securities

commissions are higher than 12b-1 fees does not necessarily mean that the plan fails to motivate financial consultants to sell fund shares. The stated purpose of the plan was to provide financial consultants with an incentive to induce customers to put their money in the CMA Money Fund rather than banks or other money funds. Dx. AY at 11-12. The discrepancy between their commission salary and 12b-1 payments bears no relationship to financial consultant incentive to promote the Fund as a better investment vehicle than banks or other funds.[54] Although assessment of the effectiveness of incentive programs is not without difficulty, the Court finds that the 12b-1 plan has contributed to the growth of the Fund.

Plaintiff also contends that a large fund does not benefit Fund shareholders; in other words, that "bigger" is not necessarily "better." In support of this argument, plaintiff points to the expert testimony of Columbia Graduate School of Business Professor Selden, who described a series of studies he performed to discover what, if any relationship existed between the size of a fund and its investment performance. Selden analyzed data from 104 money market funds, excluding the CMA funds and all other Merrill Lynch funds, and concluded that the investment performance of a fund is not affected

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[54] Plaintiff also claims that 12b-1 payments create no more incentive to distribute Fund shares than does the prospect of gaining securities commissions from CMA clients. Although the Court agrees with plaintiff that the availability of Fund assets for securities transactions encourages financial consultants to promote the Fund, the Court cannot conclude that the 13b-1 payments provide no additional incentive to sell Fund shares.

by the fund's size. T. 332-341; Px. 70-72. *See Forbes,* Sept. 8, 1986, "Annual Mutual Funds Survey." Selden testified, however, that "to the extent that increase in the size of the fund produces results in lower expenses, then it would seem to me that the shareholder would benefit." T. 339. On the basis of Selden's testimony, plaintiff argues that the Fund has not benefitted from its size, since it has no fee break points after $1 billion in assets.

After careful consideration of the methodology and conclusions of Selden's studies, the Court accepts Selden's analysis to the extent that the Court finds that plaintiff has shown that size *per se* does not noticeably affect investment performance, except insofar as a fund's expense ratio may decrease with size.[55] This conclusion does not necessarily imply, however, that the 12b-1 payments are not justifiable on other grounds, for the Court is persuaded that an inflow of assets to a fund has a positive effect on investment performance regardless of the fund's absolute size. In other words, while "bigger" may not better *per se,* "getting bigger" is better. Conversely, when a fund is losing assets due to increased redemptions, the fund is more difficult to manage.

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[55] Monagle testified that larger funds have more economic clout in the marketplace. T. 824, 827-30. While this testimony has some force, based on Selden's testimony, the Court finds that bargaining power has a negligible effect on fund performance.

The Fund's portfolio manager Joseph Monagle credibly described the difficulties faced in managing a fund with a declining level of assets.[56]

> It becomes much more difficult to manage when we are having an outflow of cash out of the portfolio. In a declining asset size, it puts us in a situation whereby we may be forced to sell securities at an inopportune time, which could force the shareholders to absorb lower yields than necessary if we were not forced to sell at that specific time.

T. 842. Monagle would not make a "blanket statement", T. 845-46, that outflow negatively affects yield because general market conditions are so important in determining yield, but he commented credibly "that if I had to make a statement, I would think that in a stable or increasing flow of funds, the rate of return to shareholders would be better." T. 846. The Court accepts Monagle's testimony that lower yields tend to result from net redemptions since timing discretion is limited and, conversely, that net purchases tend to improve performance.[57]

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[56] Monagle based this testimony on his experience as portfolio manager for the RAT when the RAT lost 40% of its assets between December 1982 and December 1983. T. 843.

[57] Plaintiff attempts to undermine Monagle's testimony by arguing that (1) since Merrill Lynch manages $35 billion of assets in its various money market funds, its economic clout could not be diminished noticeably by the loss of $4 billion from the CMA fund, and the Fund's yield is insulated during periods of net redemptions; (2) the CMA Money Fund portfolio is so actively traded that an outflow of assets could have little effect on the Fund's performance; and (3) the performance of the Fund has declined following the adoption of the 12b-1 plan and the addition of assets to the Fund.

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The Court thus concludes that the 12b-1 plan benefits Fund shareholders. Although no one has suggested a way to quantify the yield advantage, this does not mean that these benefits are ephemeral and cannot be taken into account by the Trustees. In addition, Fund shareholders benefit by improved service resulting from 12b-1 payments.[58] They may also benefit by the recruitment and retention of better management personnel who may be attracted to a larger fund.

Plaintiff also claims that the 12b-1 plan was adopted to benefit Merrill Lynch rather than the Fund. The Court has no doubt that the 12b-1 payments accrue to Merrill Lynch's advantage. The Court agrees that Merrill Lynch's asset accumulation strategy is facilitated by the 12b-1

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The evidentiary support for these arguments is minimal. First, although Merrill Lynch pools the intellectual resources of its management personnel, it does not pool the assets of its funds. Nor has plaintiff introduced evidence to show that an actively traded fund dwarfs the impact of a negative flow of cash. Indeed, the only witness questioned on this point, Trustee West, stated that even with trades of upwards of $3 billion per day, an inflow of $50 million could be important to the portfolio manager. T. 1449-50. Finally, although the Court notes a downward trend in the Fund's performance from 1984 to 1986, the Court also sees that the Fund's performance, as compared with that of other domestic prime funds, was substantially lower in 1983 than in 1982 or 1984-86. In sum, the Court finds that plaintiff has failed to prove that asset inflow is not an advantage to the Fund.

[58] The Court credits the testimony of Walsh and Zeikel that since the introduction of the 12b-1 plan financial consultants have paid more attention to the needs of the Fund shareholders.

plan.[59] The CMA program's competitive position in the central asset account market and money fund market is also enhanced. Walsh and Zeikel credibly testified that the 12b-1 plan has improved client satisfaction with the CMA program. T. 960-62 (Walsh); T. 609, 711-14 (Zeikel). The 12b-1 payments give the financial consultants a "shot in the arm" to promote the program through the Fund, and this helps Merrill Lynch compete with firms offering similar products. Indeed, the Trustee deliberations reflect concern both for the CMA program's place in a competitive market and the strength of the CMA program.[60] However, the fact that Merrill Lynch benefitted by the adoption and retention of a 12b-1 plan does not render the plan improper. It is merely one factor for Trustee consideration.

Plaintiff also asserts that use of 12b-1 payments to encourage better shareholder service and to maintain Fund size violates Rule 12b-1. The Court disagrees.

The Court concludes that disbursements by the Fund for shareholder services and maintenance of Fund size are among the expenditures the SEC wished trustees to

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[59] In addition, a large fund generates more income to Merrill Lynch in the form of advisory fees. "[T]he CMA service generates a substantial amount of fee-based income for the Firm, which goes right to [Merrill Lynch's] bottom line." Px. 26 at 1003. The Trustees also discussed the possibility that financial consultant turnover may be reduced with the introduction of the plan. *See e.g.* Px. 11 at 4.

[60] Like the 12b-1 benefits to Fund shareholders, the advantages of the 12b-1 plan to Merrill Lynch have not been quantified. The Court, however, has no doubt that the benefits are substantial.

consider in the context of Rule 12b-1's restrictions. Rule 12b-1 subjects all payments made "in connection with a distribution" to scrutiny and defines distribution as the direct or indirect financing of "any activity which is primarily intended" to result in the sale of fund shares. Payments to financial consultants to halt the out-flow of assets and improve shareholder service are consistent with this definition, so long as the *primary* intent is to increase the size of the Fund. Moreover, even if payments for shareholder service and maintenance of Fund size are not "distribution payments," *per se*, they are made "in connection with" a distribution and are therefore to be regulated by the 12b-1 plan. In sum, the Court holds that plaintiff has failed to show that these 12b-1 payments were not made in connection with activity primarily intended to result in the sale of Fund shares. Indeed, all witnesses credibly testified that the sale of Fund shares is exactly what the plan was supposed to promote. T. 595-97, 604-05, 711-16 (Zeikel); T. 917-20 (Walsh); T. 1424 (West); White Dep. 28; Forbes Dep. 50.

Finally, plaintiff claims, but has failed to prove, that the Trustees exercised neither independence nor good business judgment in adopting a plan. Rule 12b-1 does not require trustees to reduce to a dollar figure the benefits they expect a fund to receive from a plan. Nor, viewing the evidence as a whole, can the Court say the Trustees acted unreasonably. The Trustees considered the factors set forth in the applicable SEC release, examined all of the extensive information provided them by Merrill Lynch, and exercised their business judgment. Finally, the Court has found that the Fund benefits from the existence of the 12b-1 plan. In sum, the Court does not find the

Rule 12b-1 plan or any payments thereunder to be improper.

H. *The Trustees: Expertise, Knowledge, Care*

To determine if the Trustees, in approving the advisory agreement, fulfilled the fiduciary obligations imposed upon them by § 36(b) of the Act, the Court must examine that approval in light of all the surrounding circumstances. *Gartenberg I*, 694 F.2d at 928. The Court will not ignore a responsible decision by the Trustees, including a majority of the unaffiliated Trustees, to continue the fee structure as it stands. At the same time, "even if the trustees of a fund endeavored to act in a responsible fashion, an advisor-manager's fee could be so disproportionately large as to amount to a breach of fiduciary duty in violation of § 36(b)." *Id.* at 930.

The Second Circuit directs consideration of three factors by a district court: (1) the expertise of the unaffiliated trustees; (2) whether they were fully informed as to all facts bearing on the advisor-manager's service and fee; and (3) whether they exercised care and conscientiousness in the performance of their duties. *Id.*

As to the first factor, the Court finds the Trustees of the CMA Money Fund to have been highly qualified for the tasks before them. Trustees Forbes and West held significant academic positions in the investment field and the other Trustees brought to the Board extensive business experience in finance and investments. *See* Dx. AP-1, AP-2(a)-(f).

As to the second factor, Merrill Lynch provided the Trustees with a wealth of information pertinent to an evaluation of the advisory fee and the 12b-1 plan. The 1985 and 1986 Director's Manuals, the 1984, 1985 and 1986 Green Books and preliminary meeting agenda presented exhaustive information on such subjects as the Fund's performance and expense ratios, its portfolio structure and trading activities, the 12b-1 plan, including its impact on expense ratio, total income and yield, as well as comparative information on other funds. Audit Committee meetings were replete with presentations on such topics as Fund portfolio management, financial consultant reactions to the 12b-1 plan, and profitability studies. *See* Px. 10, 12; Dx. AM. Clearly, Merrill Lynch kept the Trustees fully informed as to information pertinent to their deliberations.

As to the third factor, the Court also finds that the Trustees approached their decisions with conscientiousness and care. While the Court recognizes, as did Congress in enacting ¶36(b), that, by the nature of the mutual fund industry, Fund Trustees and the advisor-manager are not at true arm's-length, the Trustees did consider the information received and did conscientiously apply it according to the standards set forth in Second Circuit case law.

Section 36(b) of the Act provides that courts should give director and shareholder approval of advisory compensation agreements "such consideration . . . as is deemed appropriate under all the circumstances." 15 U.S.C. § 80a-35(b)(2). "Inasmuch as the Court finds that the [unaffiliated Trustees] were qualified, fully informed, and extremely conscientious individuals, the [Trustees']

approval of the fee should be weighted heavily." *Schuyt*, 663 F. Supp. at 988. The Court gives this approval such weight here.

I. *Conclusion as to the § 36(b) Claim*

Plaintiff has failed to prove that, in light of the totality of the surrounding circumstances, the advisory fee received by MLAM was "so disproportionately large that it [bore] no reasonable relationship to the services rendered and could not have been the product of arm's-length bargaining." *Gartenberg I*, 694 F.2d at 928. The Court has found that the Fund shareholders, in the context of this central asset account, received services of a high caliber, that profitability to Merrill Lynch from fee based activity was well within the realm of reasonableness, even without downward adjustment for costs of financial consultants and sales assistants,[61] that plaintiff

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[61] The Court notes that in *Schuyt*, Judge Ward found profitability over a three-year period to be 59.1%, 66.8% and 77.3% respectively. After applying a stipulated tax rate of approximately fifty percent, the Court calculated profitability as approximately 29.5%, 33.4% and 38.6% for the three years. 663 F.Supp. at 978-79. Judge Ward concluded that

> [w]hile it cannot be denied that the Adviser [sic] earned a significant profit from these services, it does not appear to the Court, in light of all of the facts, that the fees charged by the Adviser [sic] were so disproportionately large that they bore no reasonable relationship to the services rendered and could not have been the product of arms-length bargaining.

Id.

Judge Ward also stated that he was not holding that profitability of up to 77.3% could never be excessive, but that, on

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has not proved significant economies of scale, that the Fund is well within normal and acceptable industry ranges as to both expenses and fees, that the 12b-1 plan was neither improperly adopted nor implemented, and that the Trustees were qualified, well informed, and conscientious and careful in their deliberations approving both the advisory fee and the 12b-1 plan. Thus, the Court has no hesitation in concluding that there was no breach of fiduciary duty under § 36(b) by MLAM or any other Merrill Lynch affiliate.

IV. *The Proxy Statement Claims*

Plaintiff also alleges that on July 26, 1984, the defendants caused the Fund to send to its shareholders a materially false and misleading proxy statement for the August 31, 1984 annual meeting. Px. 21. Plaintiff claims that this proxy statement identified comparative fees charged by the defendants for services to other funds and stated that the fee charged to the Fund averaged at approximately .38% of the Fund's asset value, *Id.* at 9, but omitted to state that the fee for the only other fund of comparable size, the Merrill Lynch Ready Assets Trust

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the facts of that case, the fees were within an arm's length range. *Id.* at n.77. He stated that such a figure could be excessive if, for example, the advisory services were not of the highest quality, and the advisors were not "so obviously qualified, fully informed, and conscientious. . . ." *Id.*

In the instant case, of course, the Court finds profitability to be much less than in *Schuyt* and also finds the advisory services to be of the highest quality and the Trustees to be highly qualified, fully informed and conscientious.

("RAT"), averaged approximately .34% of the asset value. Plaintiff also alleges that the proxy statement failed to disclose other material facts relating to defendants' profitability.

Plaintiff brings his claim under Section 20(a) of the Investment Company Act, 15 U.S.C. § 80a-20(a), and Rule 20a-1 promulgated thereunder, 17 C.F.R. § 270.20(a)-1 (making the proxy rules promulgated pursuant to § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a), applicable to securities issued by investment companies). The proxy rule applicable here is thus Rule 14a-9, 17 C.F.R. § 240.14a-9(a) which provides that:

> "(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false, or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

The principal question upon which this claim turns is whether any of the alleged undisclosed facts were "material." The Supreme Court has declared that a fact is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). Materiality cannot be determined in the abstract. The resolution of the question focuses on the

significance of the omission to a reasonable shareholder's decision and requires consideration of the "total mix" of available information to see whether the omitted fact would have been viewed by the reasonable shareholder as having altered that "total mix." *Id.; see also Spielman v. General Host Corporation*, 402 F.Supp. 190, 194 (S.D.N.Y. 1975) (Weinfeld, J.).

Viewed in the light of the foregoing standard, the Court holds that the defendants' alleged failure to state that the RAT's average fee was .34% was not a material omission. The proxy statement did not purport to set forth average fees for *any* of the funds that MLAM managed; thus, this is not a case where shareholders were affirmatively misled into believing that the average fee for the RAT was something other than .34%.

The proxy statement did set forth the fee rates of every MLAM managed fund before the *first* breakpoint, including the RAT and the Fund at .50%, and indicated at what asset level the first breakpoint occurred. Px. 21 at 7. It defined "breakpoint" as "the level of net assets at which the advisory fee is reduced." *Id.* at 8. By doing this, the statement alerted readers to the fact that there could be other breakpoints as to the funds set forth, including the RAT.

The omission of the RAT's effective fee of .34% was immaterial for several reasons. First, the RAT and the Fund are significantly different. The RAT is a stand-alone fund, while the Fund is a component of a central asset account. The two funds were not competing for the same customers. Indeed, the Fund was not being recommended by Merrill Lynch at the time to persons who were seeking

solely to invest cash in a money fund. *See* Px. 1 at iii. In addition, a comparison of the average fees of the RAT and the Fund was inappropriate, since an assessment of the Fund's fee involved considerations based upon the Fund's place in the CMA Program, including the benefits to shareholders of the program as a whole, that did not apply to the RAT. Moreover, although the Fund shareholder was not told the RAT's average fee rate in the Fund proxy statement, this information was readily available to any interested person, most recently in the RAT proxy statement sent to its shareholders approximately five weeks earlier on June 18, 1984, Px. 20, as well as in industry-wide publications, and thus was part of the "total mix" of information available to any shareholder who wanted it. Finally, it should be noted that while plaintiff seeks to make much of the difference between the effective fee rates of .38% and .34%, such a .04 differential, amounting to forty cents annually for each $1000 invested, would have meant very little to a prospective Fund shareholder.

Similarly, the omission from the shareholder proxy statement of a statement regarding the profitability of the Fund or the CMA Program to Merrill Lynch was not material. A similar claim was made and rejected by this Court in *Schuyt*, 663 F. Supp. at 989-990. Such information is neither customary nor required by the Securities and Exchange Commission and, as *Schuyt* held, is generally not material to a shareholder decision. *Id.* As this opinion painfully demonstrates, profitability analysis is no simple task. As Judge Ward stated in *Schuyt*, 663 F. Supp. at 990,

> [Profitability] information would be extremely confusing to the average shareholder and would

> require extensive discussion of full-cost accounting and the assumptions underlying the [cost allocation] system to be accurte and understandable. The Court is unwilling to impose this type of burden on defendants, particularly in the absence of evidence that such information is useful to shareholders.

For the foregoing reasons, the Court finds plaintiff's proxy violation claim to be without merit.

Conclusion

Plaintiffs' claims are dismissed. Defendants may enter judgment accordingly.

SO ORDERED.

Jeffrey KRINSK, Plaintiff-Appellant,

v.

FUND ASSET MANAGEMENT, INC., Merrill Lynch Asset Management, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc., Merrill Lynch & Co., Inc., CMA Money Fund, Defendants-Appellees.

No. 623, Docket 88-7729.

United States Court of Appeals,
Second Circuit.

Argued Jan. 9, 1989.

Decided May 31, 1989.

Shareholder filed suit on behalf of mutual fund, inter alia, to recover excessive fees allegedly collected by fund's investment advisors. The United States District Court for the Southern District of New York, John Walker, Jr., J., 654 F.Supp. 1227, granted, in part, advisors' motion to dismiss and struck advisors' demand for jury trial. Advisors appealed. The Court of Appeals, Miner, Circuit Judge, held that: (1) plaintiff failed to establish that fees were excessive; (2) proxy statement mailed to shareholders in mutual fund, seeking their approval of fees paid to investment advisors, was not materially false; and (3) shareholder was not entitled to jury trial on claims.

Affirmed

Richard M. Meyer, New York City (Melvyn I. Weiss, George A. Baur III, Milberg Weiss Bershad Specthrie & Lerach, New York City, of counsel), for plaintiff-appellant.

James N. Benedict, New York City (William P. Rogers, Mark Holland, Jordan D. Cooper, Barry W. Rashkover, Rogers & Wells, New York City, of counsel), for defendants-appellees Fund Asset Management, Inc., Merrill Lynch Asset Management, Inc., Merrill Lynch, Pierce, Fenner & Smith Inc. and Merrill Lynch & Co., Inc.

James K. Manning, New York City (Paul Windels III, Brown & Wood, New York City, of counsel), for defendant-appellee CMA Money Fund.

Philip L. Kirstein, Sr. Vice President and General Counsel, Merrill Lynch Asset Management, Inc., Plainsboro, N.J., on brief of defendants-appellees.

Before VAN GRAAFEILAND and MINER, Circuit Judges, and LASKER, District Judge.*

MINER, Circuit Judge:

Plaintiff-appellant Jeffrey Krinsk is a shareholder in the CMA Money Fund ("Fund"), which is one component of the Cash Management Account program ("CMA program"), a financial services package offered by Merrill Lynch, Pierce, Fenner & Smith Inc. ("MLPF & S"). He brought this action derivatively on behalf of the Fund against the Fund itself and those MLPF & S-related entities responsible for administering and servicing the Fund. In his amended complaint, Krinsk pleaded violations of sections 12(b), 15(a), 20(a) and 36(b) of the Investment Company Act of 1940 ("Act"), 15 U.S.C. §§ 80a-12(b), 80a-15(a), 80a-20(a), 80a-35(b) (1982), and demanded a

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* Hon. Morris E. Lasker, United States District Court for the Southern District of New York, sitting by designation.

jury trial. Krinsk alleges a breach of fiduciary duty in that the fees paid by the Fund and its shareholders are excessive; attacks the 12b-1 distribution plan as being improper; and contends that a proxy statement of the Fund was false and misleading in regard to defendants' profitability and in comparing fees of the Fund with those of another fund.

The district court rejected all of Krinsk's claims, granting pre-trial dismissal of two claims and dismissal of the remaining claims after a bench trial. Krinsk appeals from the final judgment dismissing the amended complaint.

We find no error in the district court's determination that Krinsk failed to prove that the fees are disproportionately large. In addition, we agree with the district court that there can be no private right of action under section 12(b) when the claim is indistinguishable from a section 36(b) claim; that the section 15(a) claim fails because that claim must be asserted by the shareholders rather than the Fund; that the omission in the proxy statement is not material; and that a jury trial properly was denied because the claims sound in equity.

Accordingly, we affirm.

BACKGROUND

The CMA Program and the Fund

The CMA program was introduced by MLPF & S in 1977 and has been widely imitated since that time. It consists of a bundle of financial services administered

through a central asset account that combines (1) a securities trading account, (2) a savings vehicle, consisting of one of three money market funds (one of which is the Fund) or an insured savings account, (3) a VISA debit card, (4) check-writing privileges and (5) a detailed monthly statement. The focal point of the CMA program is the securities account, which generates substantial revenue for MLPF & S. The program links the securities account to the savings vehicle through a "sweep" feature that automatically transfers idle cash into the savings vehicle – credit balances of $1,000 or more are transferred into savings the day after receipt; balances of less than $1,000 are swept weekly. An initial deposit of $20,000 is required to open a CMA program account, but a minimum balance thereafter need not be maintained.

The subject of this lawsuit, the Fund, is a no-load diversified, open-ended investment company and thus subject to provisions of the Act. The Fund is the largest registered money market mutual fund, with approximately $19 billion in assets and over 850,000 shareholders as of January 1987. Investors in the Fund hold their investment as shares, on which dividends are declared and reinvested daily. Participation in the CMA program is required in order to invest in the Fund. Participants in the program, however, are not required to invest in the Fund and instead may designate one of the other savings vehicles as their primary savings account.

Other components of the CMA program – the VISA debit card and check writing privileges – are linked to the savings vehicle and securities account, providing immediate access to money in the Fund and to margin credit. Thus, when a customer's check or VISA transaction

clears, the debt is first paid out of any free credit balance, then out of the Fund or other savings vehicle and, finally, from the margin loan value in the securities account.

MLPF & S, the sponsor of the CMA program, is the largest securities firm in the United States. It acts as a distributor for the Fund and services the individual CMA program accounts. The day-to-day management of the Fund is performed by Merrill Lynch Asset Management, Inc. ("MLAM"), which serves as investment adviser to approximately forty to fifty mutual funds as well as to institutional and individual investors. Both MLPF & S and MLAM are owned by Merrill Lynch & Co., Inc. ("ML & Co."). The Fund's investment adviser is Fund Asset Management, Inc. ("FAM"), a wholly-owned subsidiary of MLAM. These companies – MLPF & S, MLAM, ML & Co. and FAM (collectively "Merrill Lynch") – are the defendants-appellees in this action along with the Fund.

To service the accounts, MLPF & S employs financial consultants, who act as its sales representatives to investors. Supporting the financial consultants are sales assistants, an extensive "back office" operation and the services of other Merrill Lynch affiliates and subsidiaries.

Direct compensation for services and management comes from three fees: (1) a $65 annual service fee paid by each CMA program participant to MLPF & S; (2) an investment advisory fee paid by the Fund to FAM based on the Fund's asset level; and (3) payments made by the Fund to MLPF & S pursuant to a 12b-1 plan, under which the payments are passed on almost entirely to the financial consultants.

Although all program participants are obliged to pay the service fee, approximately 25% of them do not invest in the Fund. The Second fee, the advisory fee, is based on a schedule of declining percentages as assets increase beyond certain breakpoints: 0.5% of the average daily value of net assets under $500 million, 0.425% of that amount between $500 million and $1 billion, and 0.375% of that amount in excess of $1 billion. The third fee, paid pursuant to the 12b-1 plan, is based on a distribution each month at an annual rate of 12.5 basis points (0.125% of the Fund's assets), which MLPF & S passes through to the financial consultants, save for 1 basis point that it pays to sales management and up to .50 of a basis point retained for administrative costs of the program.

The Fund is governed by a Board of Trustees, comprised of one affiliated trustee and six independent trustees. The unaffiliated trustees have joined the Board at the invitation of Merrill Lynch, and each acts as a trustee or director of one or more of Merrill Lynch's other mutual funds. The Board oversees the investments and administration of the Fund, and evaluates the advisory fee annually and the 12b-1 plan quarterly. The district court found, and the parties do not dispute that the trustees were at all times fully informed on matters relevant to the issues underlying this litigation.

The investment advisory fees of the Fund have been approved by the shareholders. In July of 1984, defendants mailed to the shareholders a proxy statement, one of the principal purposes of which was to obtain shareholder approval of the continuance of the investment-advisory fee agreement. The proxy statement set forth the three-tier schedule of the Fund's advisory fee. It listed also all

the other investment companies for which FAM and MLAM act as investment advisers. The list included two columns, indicating for each of the listed companies its "Rate" and "First Breakpoint." The first of the listed money market funds was Merrill Lynch's Ready Asset Trust ("RAT"), with a listed rate of 0.5% and first breakpoint at $500 million, the same percentage and breakpoint as the Fund. The statement failed to indicate, however, the relevant differences between the RAT and the Fund – that RAT had no service fee (as opposed to the then – $50 annual charge for participation in the Fund's program) and had seven breakpoints (as opposed to the Fund's three). Also omitted in the statement was the fact that the annual rate of the advisory fee of the RAT effectively was 0.34% as opposed to 0.38% for the Fund.

The District Court Proceedings

Krinsk brought this action derivatively on behalf of the Fund against the Merrill Lynch defendants and the Fund. The suit was filed in the United States District Court for the Southern District of California on May 16, 1985, and was transferred in October of that year to the Southern District of New York, where it was assigned to Judge Walker. A jury trial was demanded in the amended complaint, which alleged that: (1) FAM and MLPF & S breached their fiduciary duties to the Fund by taking excessive fees in violation of section 36(b) of the Act, 15 U.S.C. § 80a-35(b); (2) the distribution agreement and plan entered into and continued by the Fund violates section 12(b) of the Act, 15 U.S.C. § 80a-12(b), and Securities and Exchange Commission ("SEC") Rule 12b-1, 17 C.F.R. § 270.12b-1; (3) the annual service fee required for

all program participants is not authorized by a written advisory agreement, as required by section 15(a) of the Act, 15 U.S.C. § 80-15(a); and (4) the Fund's 1984 proxy statement was materially false and misleading in omitting relevant differences between the RAT and the Fund, thus violating section 20(a) of the Act, 15 U.S.C. § 80a-20(a).[1]

In a series of comprehensive and well-reasoned opinions, Judge Walker rejected all of Krinsk's claims. The court dismissed before trial the section 12(b) claim because it was indistinguishable from the section 36(b) claim and its allowance would have permitted a circumvention of the procedural limitations of section 36(b). *Krinsk v. Fund Asset Management, Inc.*, 654 F.Supp. 1227, 1234 (S.D.N.Y. 1987). The court similarly dismissed the section 15(a) claim on the ground that the claim belonged properly to the shareholders, not to the Fund through which Krinsk derivatively brought the action. *Id.* at 1234-35. The court denied a jury trial as to the remaining claims because they sounded in equity. *Id.* at 1235-36.

After a bench trial, the court dismissed the section 36(b) claim because Krinsk failed to prove that the advisory fee was disproportionately large. *Krinsk v. Fund Asset Management, Inc.*, [1987-1988 Transfer Binder] F.Sec.L.Rep. (CCH) ¶ 93, 812, at 98, 896, 1988 WL 70589 (S.D.N.Y. June 27, 1988). Finally, the court dismissed the section 20(a)

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[1] In a fifth cause of action it was alleged that MLPF & S, MLAM and ML & Co. were controlling persons under the Act and, under section 48 of the Act, were liable for the wrongs they caused. *See* 15 U.S.C. § 80a-47 (1982). In light of the disposition hereafter made, no further discussion of this claim is necessary.

claim, holding that the omission in the proxy statement was immaterial. *Id.*[2]

Krinsk raises substantially the same issues on appeal. For the reasons that follow, we agree with the district court.

DISCUSSION

1. *Section 36(b)*

Section 36(b) of the Act places on the investment adviser of a registered investment company a fiduciary duty with respect to the receipt of compensation for services paid by the investment company or by the securities holders.[3] Krinsk contends that the trustees

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[2] Two earlier determinations of the district court are not the subjects of appeal. In the first, the court, declining to find the one-year statute of limitations of section 36(b)(3) of the Act tolled, dismissed that part of the action that claimed under section 36(b) the recoupment of alleged excessive fees paid more than one year prior to the commencement of the action. *Krinsk v. Fund Asset Management, Inc.*, [1986-1987 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 92, 730, at 93, 546, 1986 WL 205 (S.D.N.Y. May 1, 1986). In the second, defendants' motion for sanctions under Fed.R.Civ.P. 11 was denied. *Krinsk v. Fund Asset Management, Inc.*, No. 86 Civ. 8428, 1986 WL 5630 (S.D.N.Y. filed May 9, 1986). Following the issuance of these two opinions, Krinsk amended his complaint.

[3] Section 36(b) provides in relevant part that the investment advisor of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company or by the security holders thereof, to such investment advisor or any affiliated person of such investment advisor.

15 U.S.C. § 80a-35(b).

neglected this duty by taking excessive fees from the Fund. He notes that lower fees are paid by the RAT fund which is the second largest investment company affiliated with Merrill Lynch and the only fund comparable in size to the CMA Fund. He observes that despite the Fund's enormous growth, there has been no decrease in the advisory fee rate since 1979, and the rate never has been scaled down beyond the $1 billion breakpoint. He highlights as well the indirect benefits that Merrill Lynch derives from the CMA program: "non-fee-based" revenues and expenses generated from other services integral to the program, such as securities trading and margin interest; and "fall-out" benefits such as profits made by a Merrill Lynch subsidiary from trading with the Fund.

Krinsk proposes that the trustees had a duty to negotiate for the Fund the "best deal" possible. However, the standard to apply in determining whether compensation for managing a mutual fund violates the fiduciary duty imposed by section 36(b) is "whether the fee schedule represents a charge within the range of what would have been negotiated at arm's-length in the light of all of the surrounding circumstances." *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 694 F.2d 923, 928 (2d Cir. 1982), *cert. denied*, 461 U.S. 906, 103 S.Ct. 1877, 76 L.Ed.2d 808 (1983) ("*Gartenberg I*"). To violate section 36(b), "the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered." *Id.*

The following factors are to be considered in applying this standard: (a) the nature and quality of services provided to fund shareholders; (b) the profitability of the fund to the adviser-manager; (c) fallout benefits; (d)

economies of scale; (e) comparative fee structures; and (f) the independence and conscientiousness of the trustees. *See id.* at 929-30. These factors considered below *seriatim,* all weigh in favor of Merrill Lynch.

A. Nature and Quality of Services

Krinsk does not dispute that the services provided by Merrill Lynch have been only of the highest quality. From 1984 to 1986, the Fund had the third best performance out of 56 prime money funds, with an annual rate of return of 8.4% as compared to the industry average of 8%. During the same years, the Fund ranked second among the nine money market funds associated with central asset accounts.

Krinsk suggests that, because the Fund invested in high-risk items that generally are more profitable, the Fund's performance should be analyzed on a "risk-adjusted" basis. According to Krinsk, the Fund's performance would be below average when adjusted to compensate for the risk. Krinsk's expert conceded, however, that neither the SEC nor the money market industry has adopted "risk adjusted performance" as an industry standard. ¶ 93,812, at 98, 906. The district court was unwilling to impose on Merrill Lynch a performance standard "yet to be accepted" by the SEC. *Id.* The court thus did not err in rejecting that standard.

Krinsk contends also that the Fund's performance is artificially high because the $65 annual CMA program fee was not included as a Fund expense when calculating the Fund's yield. The district court did not err in rejecting this argument. The fee is not paid by the Fund, but by all

the participants in the program regardless of whether they invest in the Fund. Furthermore, Merrill Lynch presented evidence, apparently uncontradicted by Krinsk, that leading industry publications exclude such annual program fees in their computation of yields and expense ratios. The expert witness for Merrill Lynch also testified he knew of no money market fund that refers to such charges when reporting to the SEC the yields and expense ratios.

B. Profitability to Merrill Lynch

Krinsk claims that the Fund is highly profitable to Merrill Lynch, and more profitable than Merrill Lynch admits because costs attributed to the Fund should be attributed to the CMA program. Krinsk further suggests that "excessive profitability alone should suffice to support a finding of unreasonableness." He cites to no case in support of this proposition, however, and in fact courts "must look to *all* the costs and benefits associated with the Fund," *Gartenberg v. Merrill Lynch Asset Management, Inc.*, 740 F.2d 190, 194 (2d Cir. 1984) ("*Gartenberg II*").

Because the Fund is an integral part if the CMA program, it is difficult to calculate the revenues and expenses associated with the Fund apart from those associated with the other aspects of the CMA program. Merrill Lynch's accounting firm and expert at trial, Peat Marwick Mitchell & Co. ("PMM"), therefore developed a "fee-based" analysis, which subtracted fee costs from fee revenues in an effort to determine the profits derived by Merrill Lynch from the Fund. The fee revenues of the Study include the CMA program participation fee, the

advisory fee and VISA fees; the fee costs include, for example, portfolio management costs, the costs of operations and systems functions (including the sweep and checking/VISA functions), and administrative costs. Defendants introduced at trial an additional study, which they themselves prepared, that was similar to the PMM study. Krinsk had no independent profitability study prepared, but criticized the PMM and Merrill Lynch studies. The district court accepted none of the studies in full, recognizing that "[c]osts within the CMA program must be properly allocated in any profitability study lest the Fund subsidize the costs of Merrill Lynch's commission-generating activities," ¶ 93,812, at 98,908. The court therefore made its own determination as to costs and profitability. We agree with those determinations:

(1) *12-b1 Plan Fees*

The 12-b1 plan fees, as stated above, are monthly distributions to MLPF & S personnel based on the net assets in the Fund. The plan was instituted as an incentive to spur the sale of Fund shares and to stimulate improved shareholder service. These fees are paid through MLPF & S directly to its employees, except for deductions for management and administration, and are not recorded on any of defendants' audited financial statements.

The district court treated these fees in the same way as did PMM, namely, as a wash, offset by the cost of payments to the personnel. Krinsk, however, argues that because, in his view, the plan did not achieve its stated purpose – the sale of fund shares – the fees should be

counted as revenue to MLPF & S with no offsetting expenses. Since the district court found that Krinsk "failed to demonstrate that the 12b-1 payments have not contributed to the growth of the Fund," *id.* at 98, 908 n. 37, and Krinsk's own expert conceded that considering the 12b-1 payments as a fee-based cost was "within the realm if reason," we cannot say that the court's treatment of those fees was "clearly erroneous," *Gartenberg II*, 740 F.2d at 192.

(2) *Other Costs*

Krinsk attacks numerous aspects if the PMM study and the district court's findings as to systems costs, overhead, declines and overrides, CMA marketing and the allocation of certain costs to the securities side as opposed to the Fund side. Determination of these matters, involving extensive analysis of factual data, is best left to the discretion of the district court, which held a two-week trial to resolve the factual questions. There is ample evidence to support the district court's findings on these issues, and Krinsk does not advance any convincing argument that the district court erred.

(3) *Measure of Profitability*

Krinsk disputes Merrill Lynch's measure of profitability and offers instead a "return on equity" analysis utilizing a "Dupont formula." The application of the formula was flawed, however, by a speculative approach and lack of crucial figures.[4] Krinsk offers also a

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[4] The "Dupont formula" calculates return on equity by multiplying profit margin by asset turnover by leverage. Krinsk's expert lacked the asset turnover and leverage figures for the Fund or the CMA Program, and used instead figures for ML & Co.

"yardstick" analysis that compares the return on equity of the Fund with the return from other segments of the financial services industry, such as banks, insurance companies and companies dealing with stocks and bonds. According to this formula, the Fund reaps a lower return because its fee-based activities are relatively stable. Not accounted for in this formula, however, is the Fund's connection to the CMA program, which provides a variety of financial services. Moreover, the yardstick formula would reduce the Fund's advisory fee to a level far below that of any other mutual fund. The unreasonable result of applying this formula casts suspicion on the formula itself. We therefore cannot fault the district court for rejecting Krinsk's theories and crediting the testimony of Merrill Lynch's expert.

C. Fall-out Benefits

Krinsk argues that fall-out benefits should include all securities commission and margin revenues from CMA accounts, even if the benefits would have come to Merrill Lynch absent the existence of the Fund (or the CMA program). The district court rejected this definition as too broad. In *Gartenberg II*, a suit attacking Merrill Lynch's RAT fund, Judge Pollack characterized fall-out benefits as the "commissions received by [MLPF & S] that would not have been earned *but for* the fact that [MLPF & S] was able to solicit [RAT fund] shareholders." 573 F.Supp. 1293, 1313 (S.D.N.Y. 1983) (emphasis added), *aff'd*, 740 F.2d 190 (2d Cir. 1984). Krinsk urges rejection of that approach, noting that our Circuit does not require "but for" causation for costs to be offset with income from "voluntary" float benefits and free credit balances. *See*

Gartenberg II, 740 F.2d at 194. However, float benefits and free credit balances are generated directly by the money market fund and cannot be characterized as fall-out revenue. *See* 573 F.Supp. at 1312-13.

D. Economies of Scale

Krinsk alleges that Merrill Lynch's expenses, in terms of a percentage of fee-based revenues, have declined as a result of the Fund's asset growth. He argues that the Fund should receive the benefit of this economy of scale. The district court noted, however, that the fact that "expenses . . . declined at a time when the Fund size grew . . . does not establish that such decline was necessarily due to economies of scale." ¶ 93,812, at 98,913. Rather, to show economies of scale, plaintiff bore the burden of proving that the per unit cost of performing Fund transactions decreased as the number of transactions increased. *See Gartenberg I*, 528 F.Supp. 1038, 1055 (S.D.N.Y. 1981), *aff'd*, 694 F.2d 923 (2d Cir. 1982), *cert. denied*, 461 U.S. 906, 103 S.Ct. 1877, 76 L.Ed.2d 808 (1983). Krinsk offered no such evidence. Merrill Lynch, in contrast, offered evidence that the per unit costs for most money market funds generally do not decrease as a fund grows. As the Merrill Lynch view is not unreasonable, *see id.* (per unit costs of providing shareholder services remained relatively stable), we cannot say the district erred in finding that Krinsk failed to sustain his burden of proof.

E. Comparative Expense Ratios and Advisory Fees

The district court found that the Fund's expense ratio and advisory fee are not only consistent with the industry

norms, but have been among the lowest of any mutual fund in the industry. Krinsk does not dispute these findings, but instead argues that a general comparison of fees is of limited use. Indeed, we have cautioned against providing much weight to this type of comparison. *See Gartenberg I*, 694 F.2d at 929. According to Krinsk, the only viable comparison of fees would be to a fund comparable in size to the CMA Fund, and the only such fund is Merrill Lynch's RAT. That fund has an effective advisory fee that is 10% less than the CMA advisory fee. Unlike the CMA Fund, however, the RAT is a stand-alone fund, where the investors do not derive the many benefits of the central asset account.

Additionally, the district court allowed Merrill Lynch to exclude the service fee from the computation of the Fund's yield. Krinsk argues that it is inconsistent to consider benefits arising from the program components that are ancillary to the Fund to allow a higher fee, and yet not attribute that fee as a cost to the Fund. Where a money market fund is embedded in a central asset account, the apportionment of the costs and benefits is, as the district court recognized "an art rather than a science." ¶ 93,812, at 98,907. Since the fee under consideration is paid by nonshareholders of the Fund as well as shareholders, we are not prepared to say that the district court erred in allowing Merrill Lynch to exclude the fee from the computation of yield.

F. Trustees' Approval

The expertise of the trustees, whether they are fully informed, and the extent of care and conscientiousness

with which they preform their duties are among the most important factors to be examined in evaluating the reasonableness of compensation under section 36(b). *See Gartenberg I*, 694 F.2d at 930. Krinsk cannot dispute the district court's finding that the trustees were qualified and well-informed. Krinsk, however, attacks the independence and deliberations of the trustees, alleging that they did not act at arm's length, did not conclude that the 12b-1 plan would benefit shareholders before voting for it, did not consider profitability to Merrill Lynch, and were more concerned about the CMA program than the Fund of which they were the trustees. He notes, for instance, that the trustees did not fine-tune the advisory fee, as there is no breakpoint beyond $1 billion in the advisory fee schedule.

The evidence amply supports a finding that the trustees were independent and exercised care in their deliberations. For example, when the trustees were not satisfied with the profitability study Merrill Lynch prepared, they required the study to be redone. The trustees also did not violate their fiduciary duties in approving the 12b-1 incentive fee; in fact, the fee seems to have benefitted the shareholders. As a result of the creation of competing bank funds, the CMA Fund had lost approximately 25% of its assets in 1982. The 12b-1 fee was adopted to counteract this erosion of assets. By providing an incentive for the sale of shares, the 12b-1 plan created a positive cash flow for the Fund, enabling the manager to improve the Fund's performance. That the plan has had the added effect of raising morale of MLPF & S financial consultants and consequently improving the quality of services to existing Fund shareholders is no

reason to deem the plan, or the motives of the trustees, improper. *Cf. Meyer v. Oppenheimer Management Corp.*, 764 F.2d 76, 84-85 (2d Cir. 1985), *on remand*, 707 F.Supp. 1394 (S.D.N.Y. 1988). Accordingly, the district court did not err in finding that the trustees were independent and that they deliberated conscientiously.

2. *Section 12(b)*

Section 12(b) mandates that an investment company acting as a distributor of its own securities comply with the rules and regulations promulgated thereunder by the SEC. 15 U.S.C. § 80a-12(b). Under Rule 12b-1, the investment company directors are held to the fiduciary standards of section 36 when they consider whether to implement or continue a distribution plan, such as the 12b-1 plan at issue here. 17 C.F.R. § 270.12b-1 (1988).

Krinsk complains that the Fund's 12b-1 plan violates section 12(b) and SEC Rule 12b-1 in that the amounts paid by the Fund are based on the entire asset base regardless of whether any additional shares are sold. This claim, however, is a reincarnation of his "excessive fee" argument, and thus is indistinguishable from the section 36(b) claim, which encompassed the 12b-1 plan.[5] To allow this

[5] Krinsk does not allege that the plan fails to conform with the mechanical requirements of Rule 12b-1(b), a claim that might be a section 12(b) action independent of an action under section 36(b). *See Meyer*, 764 F.2d at 85. Had Krinsk raised such a claim, we might be forced to reach the issue whether there exists generally a private right of action under section 12(b), *see id.*, in light of the fact that the section, unlike section 36(b), contains no words expressly providing for a private right of action. We leave that issue, however, for another day.

claim, which is cognizable under section 36(b), to be brought under section 12(b) would be allow circumvention of the following specific procedural limitations of section 36(b), *see Tarlov v. Paine Webber Cashfund, Inc.*, 559 F.Supp. 429, 437 (D.Conn. 1983): damages may be recovered only against the recipient of the compensation, or limited to the amount of compensation, and may not be recovered for any period prior to one year before the commencement of the action, *see* Act § 36(b)(3), 15 U.S.C. § 802-35(b)(3). The district court did not err in finding that this circumvention would be impermissible.

3. *Section 15(a)*

Section 15(a) of the Act provides that no one may serve as investment adviser to a fund "except pursuant to a written contract" that "precisely describes all compensation to be paid thereunder." 15 U.S.C. § 80a-15(a). Krinsk alleges that Merrill Lynch violated this section because the $65 CMA program participation fee is not mentioned in a written agreement between the Fund and MLAM.

The first defect in Krinsk's claim is, as the district court noted, that Krinsk did not and cannot allege that the fee is advisory compensation. It is paid not to MLAM or the FAM, but to MLPF & S for program services. In *Gartenberg I,* Judge Pollack dismissed a similar section 15(a) claim against MLPF & S on the ground that MLPF & S was not an investment adviser. *See* 528 F.Supp. at 1066. Likewise, the fee here is paid to MLPF & S, which is not the investment adviser.

The second reason the claim fails is that it is not the proper subject of a derivative action. The fee is paid by

the individual participants, not the Fund. Because the fee "flow[s] directly from the investor . . . [,] the investor . . . is the proper party to assert this action, not the Fund, nor the plaintiff shareholder on behalf of the Fund," *Cohen v. Fund Asset Management, Inc.*, [1981-1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 98,433, at 92,571-92,572 (S.D.N.Y. Mar. 31, 1980).

4. *Proxy Statement under Section 20(a)*

Section 20(a) and Rule 20a-1 thereunder forbid solicitation of proxies containing any materially false or misleading statement or omission. 15 U.S.C. § 80a-20(a); 17 C.F.R. § 270.20a-1(a) (1987) (incorporating the restrictions of SEC Rules governing Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1982)). The plaintiff must establish that "there is a substantial likelihood that a reasonable shareholder would consider [the omitted fact] important in deciding how to vote," *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976); *see Schuyt v. Rowe Price Prime Reserve Fund, Inc.*, 663 F.Supp. 962, 989-90 (S.D.N.Y.) (adopting *Northway* rule to claim under Section 20(a)), *aff'd*, 835 F.2d 45 (2d Cir. 1987) (per curiam), *cert. denied*, ___ U.S. ___, 108 S.Ct. 1594, 99 L.Ed.2d 908 (1988).

The district court dismissed this claim following trial, apparently agreeing with Merrill Lynch that because the CMA Fund and the RAT are so different, comparisons would confuse rather than assist an investor, and that the omission was immaterial. We agree, The proxy statement listed the "First Breakpoint" and, in so doing, altered the reader that there could be other breakpoints. In no way

does the statement imply that these other breakpoints, if existing, would be the same. In fact, the reader would not assume from the face of the statement that for any given fund there are other breakpoints at all, as there are forty-two funds of various sizes listed under the column and some lack any breakpoint. Also, the statement cautioned that "investors seeking solely to invest cash in a money fund . . . should consider as a more suitable investment other money funds." Finally, the RAT fees were readily available, for instance, on the RAT proxy statements. This claim properly was dismissed.

5. *Jury Trial*

Krinsk contends that he was entitled to a jury trial on his sections 36(b) and 20(a) claims. As to the section 36(b) claim, a jury trial would have been improper "[s]ince the [section 36(b)] claim allege[d] nothing which would entitle plaintiff to a remedy other than equitable restitution." 654 F.Supp. at 1236. Although Krinsk insists his claim was for damages, a claim under section 36(b), even when labeled as one for damages, ordinarily should be treated as an equitable claim not for a jury. *See Schuyt*, 835 F.2d at 46 ("[t]he mere fact that [plaintiff] has designated the relief she [sought under 36(b)] as 'damages' does not mean that she is automatically entitled to a jury trial"). The complaint here, as in *Schuyt*, alleges a breach of fiduciary duty arising out of excessive fees. *See id.* In such a case, involving no claim of fraud, the remedy would be equitable and a jury trial improper. *See id.*

Likewise, Krinsk is not entitled to a jury trial for his section 20(a) claim, even though he seeks damages. As

the district court correctly noted, "a proxy misrepsentation that results in the continuation of a contract for advisory fees . . . would lead to equitable relief, such as an order to hold a new shareholders vote upon corrected proxy materials, recission or reformation of the agreement and restitution of excessive fees." 654 F.Supp. at 1236; *see also Schuyt*, 835 F.2d at 46 (denying jury trial where plaintiff's section 20(a) claim "in essence, seeks recission of the advisory agreements . . . and restitution and is thus equitable in nature").

CONCLUSION

The judgment of the district court is affirmed.

Investment Company Act of 1940, Section 1
15 U.S.C. § 80a-1 provides:

§ 80a-1. Findings and declaration of policy

(a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is found that investment companies are affected and with a national public interest in that, among other things –

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, purchased, paid for, exchanged, transferred, redeemed, and repurchased by use of the mails and means and instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous;

(2) the principal activities of such companies – investing, reinvesting, and trading in securities – are conducted by use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation;

(3) such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce;

(4) such companies are media for the investment in the national economy of a substantial part of the national savings and may

have a vital effect upon the flow of such savings into the capital markets; and

(5) the activities of such companies, extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors.

(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z-4 of this title, and facts otherwise disclosed and ascertained, it is declared that the national public interest and the interest of investors are adversely affected –

(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities;

(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

(5) when investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

(7) when investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; or

(8) when investment companies operate without adequate assets or reserves.

It is declared that the policy and purposes of this subchapter, in accordance with which the provisions of this subchapter shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

Aug. 22, 1940, c. 686, Title I, § 1, 54 Stat. 789.

Investment Company Act of 1940, Section 12
15 U.S.C. § 80a-12, provides:

§ 80a-12. Functions and activities of investment companies

Purchase of securities on margin; joint trading accounts; short sales of securities; exceptions

(a) It shall be unlawful for any registered investment company, in contravention of such rules and regulations or orders as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors –

(1) to purchase any security on margin, except such short-term credits as are necessary for the clearance of transactions;

(2) to participate on a joint or a joint and several basis in any trading account in securities, except in connection with an underwriting in which such registered company is a participant; or

(3) to effect a short sale of any security, except in connection with an underwriting in which such registered company is a participant.

Distribution by investment company of securities of which it is issuer

(b) It shall be unlawful for any registered open-end company (other than a company complying with the provisions of section 80a-10(d) of this title) to act as a distributor of securities of which it is the issuer, except through an underwriter, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Limitations on commitments as underwriter

(c) It shall be unlawful for any registered diversified company to make any commitment as underwriter, if immediately thereafter the amount of its outstanding underwriting commitments, plus the value of its investments in securities of issuers (other than investment companies) of which it owns more than 10 per centum of the outstanding voting securities, exceeds 25 per centum of the value of its total assets.

(d) Limitations on acquisition by investment companies of securities of other specific businesses

(1)(A) It shall be unlawful for any registered investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any other investment company (the "acquired company"), and for any investment company (the "acquiring company") and any company or companies controlled by such acquiring company to purchase or otherwise acquire any security issued by any registered investment company (the "acquired company"), if the acquiring company and any company or companies controlled by it immediately after such purchase or acquisition own in the aggregate –

(i) more than 3 per centum of the total outstanding voting stock of the acquired company;

(ii) securities issued by the acquired company having an aggregate value in excess of 5 per centum of the value of the total assets of the acquiring company; or

(iii) securities issued by the acquired company and all other investment companies (other than treasury stock of the acquiring company) having an aggregate value in excess of 10 per centum of the value of the total assets of the acquiring company.

(B) It shall be unlawful for any registered open-end investment company (the "acquired company"), any principal underwriter therefor, or any broker or dealer registered under the Securities Exchange Act of 1934, knowingly to sell or otherwise dispose of any security issued by the acquired company to any other investment company (the "acquiring company") or any company or companies controlled by the acquiring company, if immediately after such sale or disposition –

(i) more than 3 per centum of the total outstanding voting stock of the acquired company is owned by the acquiring company and any company or companies controlled by it; or

(ii) more than 10 per centum of the total outstanding voting stock of the acquired company is owned by the acquiring company and other investment companies and companies controlled by them.

(C) It shall be unlawful for any investment company (the "acquiring company") and any company or companies controlled by the acquiring company to purchase or otherwise acquire any security issued by a registered closed-end investment company, if immediately after such purchase or acquisition the acquiring company, other investment companies having the same investment adviser, and companies controlled by such investment companies, own more than 10 per centum of the total outstanding voting stock of such closed-end company.

(D) The provisions of this paragraph (1) shall not apply to a security received as a dividend or as a result of an offer of exchange approved pursuant to section 80a-11 of this title or of a plan of reorganization of any company (other than a plan devised for the purpose of evading the foregoing provisions).

(E) The provisions of this paragraph (1) shall not apply to a security (or securities) purchased or acquired by an investment company if –

(i) the depositor of, or principal underwriter for, such investment company is a broker or dealer registered under the Securities Exchange Act of 1934, or a person controlled by such a broker or dealer;

(ii) such security is the only investment security held by such investment company (or such securities are the only investment securities held by such investment company, if such investment company is a registered unit investment trust that issues two or more classes or series of securities, each of which provides for the accumulation of shares of a different investment company); and

(iii) in the event such investment company is not a registered investment company, the purchase or acquisition is made pursuant to an arrangement with the issuer of, or principal underwriter for the issuer of, the security whereby such investment company is obligated –

(aa) either to seek instructions from its security holders with regard to the voting of all proxies with respect to such security and to vote such proxies only in accordance with such instructions, or to vote the shares held by it in the same proportion as the vote of all other holders of such security, and

(bb) to refrain from substituting such security unless the Commission shall have approved such substitution in the manner provided in section 80a-26 of this title.

(F) The provisions of this paragraph (1) shall not apply to securities purchased or otherwise acquired by a registered investment company if –

(i) immediately after such purchase or acquisition not more than 3 per centum of the total outstanding stock of such issuer is owned by such registered investment company and all affiliated persons of such registered investment company; and

(ii) such registered investment company has not offered or sold after January 1, 1971, and is not proposing to offer or sell any security issued by it through a principal underwriter or otherwise at a public offering price which includes a sales load of more than $1^1/_2$ per centum.

No issuer of any security purchased or acquired by a registered investment company pursuant to this subparagraph shall be obligated to redeem such security in an amount exceeding 1 per centum of such issuer's total outstanding securities during any period of less than thirty days. Such investment company shall exercise voting rights by proxy or otherwise with respect to any security purchased or acquired pursuant to this subparagraph in the manner prescribed by subparagraph (E) of this subsection.

(G) For the purposes of this paragraph (1), the value of an investment company's total assets shall be computed as of the time of a purchase or acquisition or as closely thereto as is reasonably possible.

(H) In any action brought to enforce the provisions of this paragraph (1), the Commission may join as a party the issuer of any security purchased or otherwise acquired in violation of this paragraph (1), and the court may issue any order with respect to such issuer as may be necessary or appropriate for the enforcement of the provisions of this paragraph (1).

(2) It shall be unlawful for any registered investment company and any company or companies controlled by such registered investment company to purchase or otherwise acquire any security (except a security received as a dividend or as a result of a plan of reorganization of any company, other than a plan devised for the purpose of evading the provisions of this paragraph) issued by any insurance company of which such registered investment company and any company or companies controlled by such registered company do not, at the time of such purchase or acquisition, own in the aggregate at least 25 per centum of the total outstanding voting stock, if such registered company and any company or companies controlled by it own in the aggregate, or as a result of such purchase or acquisition will own in the aggregate, more than 10 per centum of the total outstanding voting stock of such insurance company.

(3) It shall be unlawful for any registered investment company and any company or companies controlled by such registered investment company to purchase or otherwise acquire any security issued by or any other interest in the business of any person who is a broker, a dealer, is engaged in the business of underwriting, or is either an investment adviser of an investment company

or an investment adviser registered under subchapter II of this chapter, unless (A) such person is a corporation all the outstanding securities of which (other than short-term paper, securities representing bank loans, and directors' qualifying shares) are, or after such acquisition will be, owned by one or more registered investment companies; and (B) such person is primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, or any one or more of such or related activities, and the gross income of such person normally is derived principally from such business or related activities.

Acquisition of securities issued by corporations in business of underwriting, furnishing capital to industry, etc.

(e) Notwithstanding any provisions of this subchapter, any registered investment company may hereafter purchase or otherwise acquire any security issued by any one corporation engaged or proposing to engage in the business of underwriting, furnishing capital to industry, financing promotional enterprises, purchasing securities of issuers for which no ready market is in existence, and reorganizing companies or similar activities; provided –

(1) That the securities issued by such corporation (other than short-term paper and securities representing bank loans) shall consist solely of one class of common stock and shall have been originally issued or sold for investment to registered investment companies only;

(2) That the aggregate cost of the securities of such corporation purchased by such registered investment company does not exceed 5 per centum of the value of the total assets of such registered company at the time of any purchase or acquisition of such securities; and

(3) That the aggregate paid-in capital and surplus of such corporation does not exceed $100,000,000.

For the purpose of paragraph (1) of section 80a-5(b) of this title any investment in any such corporation shall be deemed to be an investment in an investment company.

(f) Organization and ownership by one registered face-amount certificate company of all or part of capital stock of not more than two other face-amount certificate companies; limitations

Notwithstanding any provisions of this chapter, any registered face-amount certificate company may organize not more than two face-amount certificate companies and acquire and own all or any part of the capital stock thereof only if such stock is acquired and held for investment: *Provided,* That the aggregate cost to such registered company of all such stock so acquired shall not exceed six times the amount of the minimum capital stock requirement provided in subdivision (1) of subsection (a) of section 80a-28 of this title for a face-amount company organized on or after March 15, 1940: *And provided further,* That the aggregate cost to such registered company of all such capital stock issued by face-amount certificate companies organized or otherwise created under laws other than the laws of the United States or any State thereof shall not exceed twice the amount of the minimum capital

stock requirement provided in subdivision (1) of subsection (a) of said section 80a-28 for a company organized on or after March 15, 1940. Nothing contained in this subsection shall be deemed to prevent the sale of any such stock to any other person if the original purchase was made by such registered face-amount certificate company in good faith for investment and not for resale.

Exceptions to limitation on ownership by investment company of securities of insurance company

(g) Notwithstanding the provisions of this section any registered investment company and any company or companies controlled by such registered company may purchase or otherwise acquire from another investment company or any company or companies controlled by such registered company more than 10 per centum of the total outstanding voting stock of any insurance company owned by any such company or companies, or may acquire the securities of any insurance company if the Commission by order determines that such acquisition is in the public interest because the financial condition of such insurance company will be improved as a result of such acquisition or any plan contemplated as a result thereof. This section shall not be deemed to prohibit the promotion of a new insurance company or the acquisition of the securities of any newly created insurance company by a registered investment company, alone or with other persons. Nothing contained in this section shall in any way affect of derogate from the powers of any insurance commissioner or similar official or agency of the United States or any State, or to affect the right under State law of any insurance company to acquire securities of any other insurance company or insurance companies.

Aug. 22, 1940, c. 686, Title I, § 12, 54 Stat. 808; Dec. 14, 1970, Pub.L. 91-547, § 7, 84 Stat. 1417. (As amended Dec. 4, 1987, Pub.L. 100-181,Title VI, § 610, 101 Stat. 1261.)

Investment Company Act of 1940, Section 15, U.S.C. § 80a-15, provides:

§ 80a-15. Contracts of advisers and underwriters

Written contract to serve or act as investment adviser; contents

(a) It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and –

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of

the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment.

Written contract with company for sale by principal underwriter of security of which company is issuer; contents

(b) It shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract –

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

Approval of contract to undertake service as investment adviser or principal underwriter by majority of noninterested directors

(c) In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors,

who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company. It shall be unlawful for the directors of a registered investment company, in connection with there evaluation of the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company, to take into account the purchase price or other consideration any person may have paid in connection with a transaction of the type referred to in paragraph (1),(3), or (4) of subsection (f) of this section.

(d) Equivalent of vote of majority of outstanding voting securities in case of common-law trust

In the case of a common-law trust of the character described in section 80a-16(c) of this title, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (42) of section 80a-2(a) of this title as to a majority shall be applicable to the vote cast at such a meeting.

Exemption of advisory boards or members from provisions of this section

(e) Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

Receipt of benefits by investment adviser from sale of securities or other interest in such investment adviser resulting in assignment of investment advisory contract

(f)(1) An investment adviser, or a corporate trustee performing the functions of an investment adviser, of a registered investment company or an affiliated person of such investment adviser or corporate trustee may receive any amount or benefit in connection with a sale of securities of, or a sale of any other interest in, such investment adviser or corporate trustee which results in an assignment of an investment advisory contract with such company or the change in control of or identity of such corporate trustee, if –

(A) for a period of three years after the time of such action, at least 75 per centum of the members of the board of directors of such registered company or such corporate trustee (or successor thereto, by reorganization or otherwise) are not (i) interested persons of the investment adviser of such company or such corporate trustee, or (ii) interested persons of the predecessor investment adviser or such corporate trustee; and

(B) there is not imposed an unfair burden on such company as a result of such transaction

or any express or implied terms, conditions, or understandings applicable thereto.

(2)(A) For the purpose of paragraph (1)(A) of this subsection, interested persons of a corporate trustee shall be determined in accordance with section 80a-2(a)(19)(B) of this title: *Provided,* That no person shall be deemed to be an interested person of a corporate trustee solely by reason of (i) his being a member of its board of directors or advisory board or (ii) his membership in the immediate family of any person specified in clause (i) of this subparagraph.

(B) For the purpose of paragraph (1)(B) of this subsection, an unfair burden on a registered investment company includes any arrangement, during the two-year period after the date on which any such transaction occurs, whereby the investment adviser or corporate trustee or predecessor or successor investment advisers or corporate trustee or any interested person of any such adviser or any such corporate trustee receives or is entitled to receive any compensation directly or indirectly (i) from any person in connection with the purchase or sale of securities or other property to, from, or on behalf of such company, other than bona fide ordinary compensation as principal underwriter for such company, or (ii) from such company or its security holders for other than bona fide investment advisory or other services.

(3) If -

(A) an assignment of an investment advisory contract with a registered investment company results in a successor investment adviser to such company, or if there is a change in control of or identity of a corporate trustee of a

registered investment company, and such adviser or trustee is then an investment adviser or corporate trustee with respect to other assets substantially greater in amount than the amount of assets of such company, or

(B) as a result of a merger of, or a sale of substantially all the assets by, a registered investment company with or to another registered investment company with assets substantially greater in amount, a transaction occurs which would be subject to paragraph (1)(A) of this subsection, such discrepancy in size of assets shall be considered by the Commission in determining whether or to what extent an application under section 80a-6(c) of this title for exemption from the provisions of paragraph (1)(A) of this subsection should be granted.

(4) Paragraph (1)(A) of this subsection shall not apply to a transaction in which a controlling block of outstanding voting securities of an investment adviser to a registered investment company or of a corporate trustee performing the functions of an investment adviser to a registered investment company is –

(A) distributed to the public and in which there is, in fact, no change in the identity of the persons who control such investment adviser or corporate trustee, or

(B) transferred to the investment adviser or the corporate trustee, or an affiliated person or persons of such investment adviser or corporate trustee, or is transferred from the investment adviser or corporate trustee to an affiliated person or persons of the investment adviser or corporate trustee: *Provided*, That (i) each transferee (other than such adviser or trustee) is a natural person and (ii) the transferees (other than such adviser or trustee) owned in the

aggregate more than 25 per centum of such voting securities for a period of at least six months prior to such transfer.

Aug. 22, 1940, c. 686, Title I, § 15, 54 Stat. 812; Dec. 14, 1970, Pub. L. 91-547, § 8, 84 Stat. 1419; June 4, 1975, Pub.L. 94-29, § 28(1), (2), (4), 89 Stat. 164, 165. (As amended Dec. 4, 1987, Pub.L. 100-181, Title VI, § 611, 101 Stat. 1261.)

Investment Company Act of 1940, Section 20,
15 U.S.C. § 80a-20, provides:

§ 80a-20. Proxies; voting trusts; circular ownership

Prohibition on use of means of interstate commerce for solicitation of proxies

(a) It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) Prohibition on use of means of interstate commerce for sale of voting-trust certificates

It shall be unlawful for any registered investment company or affiliated person thereof, any issuer of a

voting-trust certificate relating to any security of a registered investment company, or any underwriter of such a certificate, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to offer for sale, sell or deliver after sale, in connection with a public offering, any such voting-trust certificate.

Prohibition on purchase of securities knowingly resulting in cross-ownership or circular ownership

(c) No registered investment company shall purchase any voting security if, to the knowledge of such registered company, cross-ownership or circular ownership exists, or after such acquisition will exist, between such registered company and the issuer of such security. Cross-ownership shall be deemed to exist between two companies when each of such companies beneficially owns more than 3 per centum of the outstanding voting securities of the other company. Circular ownership shall be deemed to exist between two companies if such companies are included within a group of three or more companies, each of which –

(1) beneficially owns more than 3 per centum of the outstanding voting securities of one or more other companies of the group; and

(2) has more than 3 per centum of its own outstanding voting securities beneficially owned by another company, or by each of two or more other companies, of the group.

(d) Duty to eliminate existing cross-ownership or circular ownership

If cross-ownership or circular ownership between a registered investment company and any other company or companies comes into existence upon the purchase by a registered investment company of the securities of another company, it shall be the duty of such registered company, within one year after it first knows of the existence of such cross-ownership or circular ownership, to eliminate the same.

Aug. 22, 1940, c. 686, Title I, § 20, 54 Stat. 822.

(As amended Dec. 4, 1987, Pub.L. 100-181, Title VI, § 614, 101 Stat. 1262.)

Investment Company Act of 1940, Section 36, 15 U.S.C. § 80a-35, provides:

§ 80a-35. Breach of fiduciary duty

Civil actions by Commission; jurisdiction; allegations; injunctive or other relief

(a) The Commission is authorized to bring an action in the proper district court of the United States, or in the United States court of any territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has engaged within five years of the commencement of the action or is about to engage in any act or practice constituting a breach of fiduciary duty involving personal misconduct in respect of any registered investment company for which such person so serves or acts –

(1) as officer, director, member of any advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If such allegations are established, the court may enjoin such persons from acting in any or all such capacities either permanently or temporarily and award such injunctive or other relief against such person as may be reasonable and appropriate in the circumstances, having due regard to the protection of investors and to the effectuation of the policies declared in section 80a-1(b) of this title.

(b) Compensation or payments as basis of fiduciary duty; civil actions by Commission or security holder; burden of proof; judicial consideration of director of shareholder approval; persons liable; extent of liability; exempted transactions; jurisdiction; finding restriction

For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser. An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this section who has a fiduciary duty concerning such compensation or payments, for

breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person. With respect to any such action the following provisions shall apply:

(1) It shall not be necessary to allege or prove that any defendant engaged in personal misconduct, and the plaintiff shall have the burden of proving a breach of fiduciary duty.

(2) In any such action approval by the board of directors of such investment company of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, and ratification or approval of such compensation or payments, or of contracts or other arrangements providing for such compensation or payments, by the shareholders of such investment company, shall be given such consideration by the court as is deemed appropriate under all the circumstances.

(3) No such action shall be brought or maintained against any person other than the recipient of such compensation or payments, and no damages or other relief shall be granted against any person other than the recipient of such compensation or payments. No award of damages shall be recoverable for any period prior to one year before the action was instituted. Any award of damages against such recipient shall be limited to the actual damages resulting from the breach of fiduciary duty and shall in no event exceed the amount of compensation or payments received from such investment company, or the security holders thereof, by such recipient.

(4) This subsection shall not apply to compensation or payments made in connection with transactions subject to section 80a-17 of this title, or rules, regulations, or orders thereunder, or to sales loads for the acquisition of any security issued by a registered investment company.

(5) Any action pursuant to this subsection may be brought only in an appropriate district court of the United States.

(6) No finding by a court with respect to a breach of fiduciary duty under this subsection shall be made a basis (A) for a finding of a violation of this subchapter for the purposes of sections 80a-9 and 80a-48 of this title, section 78*o* of this title, or section 80b-3 of this title, or (B) for an injunction to prohibit any person from serving in any of the capacities enumerated in subsection (a) of this section.

Corporate or other trustees performing functions of investment advisers

(c) For the purposes of subsections (a) and (b) of this section, the term "investment adviser" includes a corporate or other trustee performing the functions of an investment adviser.

Aug. 22, 1940, c. 686, Title I, § 36, 54 Stat. 841; Dec. 14, 1970, Pub.L. 91-547, § 20, 84 Stat. 1428; June 4, 1975, Pub.L. 94-29, § 28(7), 89 Stat. 166. (As amended Dec. 4, 1987, Pub.L. 100-181, Title VI, § 622, 101 Stat. 1262.)

Investment Company Act of 1940, Section 44,
15 U.S.C. § 80a-43, provides:

§ 80a-43. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 80a-33 of this title, or upon a failure to file a report or other document required to be filed under this subchapter, may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court. The Commission may intervene as a party in any action or suit to enforce any liability or duty created by, or to enjoin any noncompliance with, section 80a-35(b) of this title at any

stage of such action or suit prior to final judgment therein.

Aug. 22, 1940, c. 686, Title I, § 44, 54 Stat. 844; Dec. 14, 1970, Pub.L. 91-547, § 22, 84 Stat. 1430.

Securities and Exchange Commission Rule 12b-1, 17 C.F.R. § 270.12b-1, provides:

(a)(1) Except as provided in this section, it shall be unlawful for any registered open-end management investment company (other than a company complying with the provisions of Section 10(d) of the Act [15 U.S.C. 80a-10(d)]) to act as a distributor of securities of which it is the issuer, except through an underwriter.

(2) For purposes of this section, such a company will be deemed to be acting as a distributor of securities of which it is the issuer, other than through an underwriter, if it engages directly or indirectly in financing any activity which is primarily intended to result in the sale of shares issued by such company, including, but not necessarily limited to, advertising, compensation of underwriters, dealers, and sales personnel, the printing and mailing of prospectuses to other than current shareholders, and the printing and mailing of sales literature.

(3) A registered, open-end management investment company ("company") may act as a distributor of securities of which it is the issuer, *Provided* That any payments made by such company in connection with such distribution are made pursuant to a written plan describing all material aspects of the proposed financing of distribution and that all agreements with any person relating to implementation of the plan are in writing, *and further provided* that:

(1) Such plan has been approved by a vote of at least a majority of the outstanding voting securities of such company;

(2) Such plan, together with any related agreements, has been approved by a vote of the board of directors of such company, and of the directors who are not interested persons of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan, cast in person at a meeting called for the purpose of voting on such a plan or agreements; and

(3) Such plan or agreement provides, in substance:

(i) That it shall continue in effect for a period of more than one year from the date of its execution or adoption only so long as such continuance is specifically approved at least annually in the manner described in paragraph (b)(2);

(ii) That any person authorized to direct the disposition of monies paid or payable by such company pursuant to the plan or any related agreement shall provide to the company's board of directors, and the directors shall review, at least quarterly, a written report of the amounts so expended and the purposes for which such expenditures were made; and

(iii) In the case of a plan, that it may be terminated at any time by vote of a majority of the members of the board of directors of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan or by a vote of a majority of the outstanding voting securities of such company; and

(iv) In the case of an agreement related to a plan,

(A) That it may be terminated at any time, without the payment of any penalty, by vote of a majority of the members of the board of directors of such company who, are not interested persons of the company and have no direct or indirect financial interest in the operation of the plan or in any agreements related to the plan or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to any party to the agreement, and

(B) For its automatic termination in the event of its assignment; and

(4) Such plan provides that it may not be amended to increase materially the amount to be spent for distribution without shareholder approval and that all material amendments of the plan must be approved in the manner described in paragraph (b)(2);

(5) Such plan is implemented and continued in a manner consistent with the provisions of paragraphs (c), (d), and (e) of this section;

(c) A registered open-end management investment company may rely on the provisions of paragraph (b) of this section only if selection and nomination of those directors who are not interested persons of such company are committed to the discretion of such disinterested directors;

(d) In considering whether a registered open-end management investment company should implement or continue a plan in reliance on paragraph (b) of this section, the directors of such company shall have a duty to request and evaluate, and any person who is a party to any agreement with such company relating to such

plan shall have a duty to furnish, such information as may reasonably be necessary to an informed determination of whether such plan should be implemented or continued; in fulfilling their duties under this paragraph the directors should consider and give appropriate weight to all pertinent factors, and minutes describing the factors considered and the basis for the decision to use company assets for distribution must be made and preserved in accordance with paragraph (f) of this section;

NOTE: For a discussion of factors which may be relevant to a decision to use company assets for distribution, see Investment Company Act Releases Nos. 10862, September 7, 1979, and 11414, October 28, 1980.

(e) A registered open-end management investment company may implement or continue a plan pursuant to paragraph (b) of this section only if the directors who vote to approve such implementation or continuation conclude, in the exercise of reasonable business judgment and in light of their fiduciary duties under state law and under sections 36(a) and (b) [15 U.S.C. 80a-35(a)and (b)] of the Act, that there is a reasonable likelihood that the plan will benefit the company and its shareholders; and

(f) A registered open-end management investment company must preserve copies of any plan, agreement or report made pursuant to this section for a period of not less than six years from the date of such plan, agreement or report, the first two years in an easily accessible place.

Title 17 – Commodity and Securities Exchanges; Revised as of April 1, 1988

CHAPTER II – SECURITIES AND EXCHANGE COMMISSION

PART 270 – RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

§ 270.20a-1 Solicitation of proxies, consents and authorizations.

17 CFR 270.20a-1

(a) No person shall solicit or permit the use of his name to solicit any proxy consent or authorization in respect of any security of which a registered investment company is the issuer, except upon compliance with §§ 270.20a-2 and 270.20a-3 and all rules and regulations adopted pursuant to section 14(a) of the Securities Exchange Act of 1934 that would be applicable to such solicitation if it were made in respect of a security registered on a national securities exchange. Unless the solicitation is made in respect of a security registered on a national securities exchange, none of the soliciting material need be filed with such exchange.

(b) If the solicitation is made by or on behalf of the management of the investment company, then the investment advisor or any prospective investment advisor and any affiliated person thereof as to whom information is required in the solicitation shall upon request of the investment company promptly transmit to the investment company all information necessary to enable the management of such company to comply with the rules and regulations applicable to such solicitation. If the solicitation is made by any person other than the management of

the investment company, on behalf of and with the consent of the investment adviser or prospective investment adviser, then the investment adviser or prospective investment adviser and any affiliated person thereof as to whom information is required in the solicitation shall upon request of the person making the solicitation promptly transmit to such person all information necessary to enable such person to comply with the rules and regulations applicable to the solicitation.

(c) In lieu of the fees specified in Rule 14a-6 of the general rules and regulations under the Securities Exchange Act of 1934, at the time of filing the preliminary solicitation material or, if no preliminary solicitation material is filed, at the time of filing the definitive solicitation material, the person upon whose behalf the solicitation is made shall pay to the Commission a fee of $125, no part of which shall be refunded.

SOURCE: 25 FR 1865, Mar. 3, 1960, as amended at 37 FR 1472, Jan. 29, 1972; 52 FR 48985, Dec. 29, 1987

AUTHORITY: Secs. 38, 40, 54 Stat. 841, 842; 15 U.S.C. 80a-37, 80c-89; The Investment Company Act of 1940, as amended, 15 U.S.C. 80a-1 et seq.

PLAINTIFF'S TRIAL EXHIBIT 21

CMA MONEY FUND

NOTICE OF 1984 ANNUAL MEETING OF SHAREHOLDERS

August 31, 1984

To The Shareholders of
CMA Money Fund

Notice is hereby given that the 1984 Annual Meeting of Shareholders (the "Meeting") of CMA Money Fund (the "Fund") will be held at the offices of Merrill Lynch, Pierce, Fenner & Smith Incorporated, on the 20th floor of One Liberty Plaza, 165 Broadway, New York, New York on Friday, August 31, 1984 at 1:00 P.M. for the following purposes:

(1) To elect seven Trustees to serve for the ensuing year;

(2) To ratify or reject the selection of Deloitte Haskins & Sells as independent certified public accountants of the Fund for its fiscal year ending March 31, 1985;

(3) To consider and act upon the proposal to approve the continuance of the Investment Advisory Agreement between the Fund and Fund Asset Management, Inc. ("FAMI"); and

(4) To transact such other business as may properly come before the Meeting or any adjournment thereof.

The Trustees have fixed the close of business on July 16, 1984 as the record date for the determination of shareholders entitled to notice of and to vote at the Meeting or any adjournment thereof.

A complete list of the shareholders of the Fund entitled to vote at the Meeting will be available and open to the examination of any shareholder of the Fund for any purpose germane to the Meeting during ordinary business hours from and after August 17, 1984, at the office of the Fund, 633 Third Avenue, New York, New York 10017.

You are cordially invited to attend the Meeting. Shareholders who do not expect to attend the Meeting in person are requested to complete, date and sign the enclosed form of proxy and return it promptly in the envelope provided for that purpose. The enclosed proxy is being solicited by the Trustees of the Fund.

By Order of the Trustees

PHILIP L. KIRSTEIN
Secretary

New York, New York
Dated: July 26, 1984

PROXY STATEMENT

CMA MONEY FUND

633 Third Avenue
New York, New York 10017

1984 Annual Meeting of Shareholders

August 31, 1984

INTRODUCTION

This Proxy Statement is furnished in connection with the solicitation of proxies on behalf of the Trustees of CMA Money Fund, a Massachusetts business trust (the "Fund"), to be voted at the 1984 Annual Meeting of

Shareholders of the Fund (the "Meeting"), to be held at the offices of Merrill Lynch, Pierce, Fenner & Smith Incorporated on the 20th floor of One Liberty Plaza, 165 Broadway, New York, New York on Friday, August 31, 1984 at 1:00 P.M. The approximate mailing date of this Proxy Statement is July 27, 1984.

All properly executed proxies received prior to the Meeting will be voted at the Meeting in accordance with the instructions marked thereon or otherwise as provided therein. Unless instructions to the contrary are marked, proxies will be voted for the election of seven Trustees, for the ratification of the selection of independent certified public accountants and for the approval of the continuance of the investment advisory agreement between the Fund and Fund Asset Management, Inc. ("FAMI"). Any proxy may be revoked at any time prior to the exercise thereof by giving notice to the Secretary of the Fund.

The Trustees have fixed the close of business on July 16, 1984 as the record date for the determination of shareholders entitled to notice of and to vote at the Meeting and at any adjournment thereof. Shareholders on the record date will be entitled to one vote for each share held, with no shares having cumulative voting rights. As of July 16, 1984, the Fund had outstanding 13,443,737,539 shares of beneficial interest, par value $0.10 per share. To the knowledge of management of the Fund, no person owned beneficially more than 5 percent of its outstanding shares at such date.

The Trustees of the Fund know of no business other than that mentioned in Items 1 through 3 of the Notice of

Meeting which will be presented for consideration at the Meeting. If any other matter is properly presented, it is the intention of the persons named in the enclosed proxy to vote in accordance with their best judgment.

ELECTION OF TRUSTEES

At the Meeting seven Trustees will be elected to serve until the next Annual Meeting of Shareholders and until their successors are elected and qualified. It is the intention of the persons named in the enclosed proxy to nominate and vote in favor of the election of the persons listed below.

Each nominee listed below has consented to continue to serve as a Trustee. The Trustees of the Fund know of no reason why any of these nominees will be unable to serve, but in the event of any such unavailability, the proxies received will be voted for such substitute nominees as the Trustees may recommend.

Certain information concerning the nominees is set forth below.

Name and Address of Nominee	Age	Principal Occupations During Past Five Years and Public Directorships (1)	Trustee Since	Shares of the Fund beneficially owned at June 29, 1984
Howard O. Colgan, Jr. (2) 650 Beach Road John's Island Vero Beach, Florida 32963	72	Partner, Milbank, Tweed, Hadley & McCloy, attorneys, from 1947 to 1977; Consulting Partner from 1977 to 1980; Retired Partner since 1980.	1977	44,492
Ronald W. Forbes (2) 1400 Washington Avenue Albany, New York 12222	42	Associate Professor, formerly Assistant Professor of Finance, School of Business, State University of New York at Albany; Member, Task Force on Municipal Securities Markets, Twentieth Century Fund; Consultant, Public Finance Banking, Shearson Lehman/American Express Inc.	1981	-0-

Name and Address of Nominee	Age	Principal Occupations During Past Five Years and Public Directorships (1)	Trustee Since	Shares of the Fund beneficially owned at June 29, 1984
Thomas H. Lenagh (2) .... 300 E. Carpenter Freeway Irving, Texas 75062	64	Chairman and Chief Executive Officer of Greiner Engineering, Inc.; Financial advisor since 1980; Financial Vice President of Aspen Institute for Humanistic Studies (cultural organization) from 1978 to 1979; formerly Treasurer, The Ford Foundation; Director, Adams Express Company, CML Group Inc. (recreation products), ICN Pharmaceuticals, Inc., Microsonics Inc. (educational equipment), SCI Systems Inc., USLIFE Corporation, Gintel Funds, Inc., Tosco Corporation and Irvine Sensors, Inc. (high technology).	1981	-0-

Name and Address of Nominee	Age	Principal Occupations During Past Five Years and Public Directorships (1)	Trustee Since	Shares of the Fund beneficially owned at June 29, 1984
Richard T. O'Reilly (2) .... Rockwood Lane Spur Greenwich, Connecticut 06830	62	Marketing and advertising consultant since 1976; Vice Chairman and Director of Wells, Rich, Greene, Inc. (advertising agency) from 1969 to 1976; Director of ADV Fund, Inc., Tudor Fund, Inc., Specialty Brands Inc. (food company) and a Trustee of Capital Cash Management Trust.	1980	-0-

Name and Address of Nominee	Age	Principal Occupations During Past Five Years and Public Directorships (1)	Trustee Since	Shares of the Fund beneficially owned at June 29, 1984
Richard R. West (2) Amos Tuck School of Business Administration Dartmouth College Hanover, New Hampshire 03755	46	Professor of Finance at the Amos Tuck School of Business Administration since 1976 and Dean from 1976 to 1983; Director, SCM Corporation (diversified manufacturer), Vornado, Inc. (real estate holding company). The Mexico Fund, Inc., The Dorsey Corporation (manufacturer of glass and plastic containers and tractor trailers). Addison-Wesley Publishing Company and Sykes Datatronics (electronics company).	1979	3,911

Name and Address of Nominee	Age	Principal Occupations During Past Five Years and Public Directorships (1)	Trustee Since	Shares of the Fund beneficially owned at June 29, 1984
Marc A. White (2) 511 Savings Bank Building Ithaca, New York 14850	63	Lawyer in private practice.	1979	-0-
Arthur Zeikel (3) 633 Third Avenue New York, New York 10017	52	President, Director and Chief Investment Officer of Fund Asset Management, Inc. ("FAMI") since 1977; President of Merrill Lynch Asset Management, Inc. ("MLAM") since 1977 and Director and Chief Investment Officer since 1976; Director of Merrill Lynch since 1981.	1977	-0-

(1) Each of the nominees is a director of certain other investment companies for which the Investment Adviser of its parent acts as investment adviser. See "Merrill Lynch investment company directorships" below.

(2) Member of Audit Committee and Nominating Committee of the Board of Trustees.

(3) Interested person, as defined in the Investment Company Act of 1940, of the Fund.

See "Pending Litigation and Legal Matters"on page 13 for information concerning a shareholder derivative action which names five of the present Trustees of the Fund as individual defendants.

Committees and Trustees' meetings. The Trustees have a standing Audit Committee and a Nominating Committee, each of which consists of the Trustees who are not "interested persons" of the Fund within the meaning of the Investment Company Act of 1940. The purposes of the Audit Committee are (i) to review the scope of the annual audit conducted by the Fund's independent certified public accountants and the evaluation by such accountants of the accounting procedures followed by the Fund and (ii) to consider matters generally within the responsibility of the non-interested directors of investment companies under the Investment Company Act of 1940. The purpose of the Nominating Committee is to select and nominate the Trustees who are not "interested persons" of the Fund as defined in the Investment Company Act of 1940. The Nominating Committee generally will not consider nominees recommended by shareholders of the Fund.

During the Fund's fiscal year ended March 31, 1984, the Trustees held four meetings, the Audit Committee held four meetings and the Nominating Committee held no meetings. Each Trustee nominated for election attended at least 75 percent of the aggregate of the number of these meetings of the Trustees and, if a member, of the Audit Committee held during the period he served as a Trustee.

Interested persons. The Fund considers one of its Trustees, Mr. Zeikel, to be an "interested person" of the Fund within the meaning of Section 2(a)(19) of the Investment Company Act of 1940. Mr. Zeikel is the President of the Fund, the President and a Director of FAMI and its parent corporation, MLAM, and a Director of Merrill Lynch.

Compensation of Trustees. FAMI, the investment adviser, pays all compensation of all officers of the Fund and all Trustees of the Fund who are affiliated with Merrill Lynch & Co., Inc. or its subsidiaries. The Fund presently pays each unaffiliated Trustee an annual fee of $10,000 plus $1,500 per meeting attended and pays all Trustees' actual out-of-pocket expenses relating to attendance at meetings. The non-interested Trustees receive $900 for each meeting of the Audit Committee attended. The aggregate fees and expenses paid to the unaffiliated Trustees totaled $139,706 for the year ended March 31, 1984.

Merrill Lynch investment company directorships. FAMI and its parent, MLAM, act at the investment adviser for twenty-seven registered open-end investment companies.

Mr. Zeikel is a trustee or director of each of these companies except for Merrill Lynch Government Fund Inc., Merrill Lynch Institutional Fund Inc. and Merrill Lynch Institutional Tax-Exempt Fund. Each of the nominees is a trustee of CMA Government Securities Fund, CMA Tax-Exempt Fund, CBA Money Fund, and Merrill Lynch Fund for Tomorrow, Inc. Each of the nominees is a director of Merrill Lynch Corporate Bond Fund, Inc., Merrill Lynch Municipal Bond Fund, Inc., The Corporate Fund Accumulation Program, Inc. and The Municipal Fund Accumulation Program, Inc. In addition, Messrs. O'Reilly and West are directors of Sci/Tech Holdings, Inc. and Merrill Lynch International Holdings, Inc. and Mr. O'Reilly is a director of Merrill Lynch Pacific Fund, Inc.

Officers of the Fund. The Board of Trustees has elected five officers of the Fund. The following sets forth information concerning each of these officers:

Name and Principal Occupation	Office	Age	Officer Since
Arthur Zeikel. . . . . President, Director and Chief Investment Officer of FAMI since 1977; President of MLAM since 1977 and Director and Chief Investment Officer since 1976; Director of Merrill Lynch since 1981	President	52	1977
N. John Hewitt . . . . Senior Vice President of MLAM and FAMI since 1980 and Vice President from 1976 to 1980	Vice President	49	1977
Harry Escobar . . . . Vice President of MLAM and FAMI since 1980; associated with MLAM and FAMI since 1978; institutional salesman with Donaldson, Lufkin & Jenrette Securities Corporation from 1976 to 1978	Vice President	39	1979

Name and Principal Occupation	Office	Age	Officer Since
Gerald M. Richard .... Senior Vice President and Treasurer of MLAM since 1984; Treasurer of Merrill Lynch Funds Distributor, Inc. (the "Distributor") since 1984 and Vice President since 1981; employee of the Distributor since 1978	Treasurer	35	1984
Philip L. Kirstein .... Senior Vice President and General Counsel of MLAM since 1984, Vice President since 1983 and on the legal staff of MLAM since 1980; attorney associated with Townley & Updike from 1974 to 1980	Secretary	39	1982

Share ownership. On July 16, 1984, the Trustees and officers of the Fund as a group (11 persons) owned an aggregate of less than 1/10 of 1% of the outstanding shares of beneficial interest of the Fund. Mr. Zeikel, a Trustee of the Fund, and the officer of the Fund owned on July 16, 1984, an aggregate of less than 1/4 of 1% of the outstanding shares of Common Stock of Merrill Lynch & Co., Inc.

SELECTION OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

At their meeting on June 13, 1984, the Trustees of the Fund, including a majority of the Trustees who are not interested persons of the Fund, selected the firm of Deloitte Haskins & Sells ("DH&S"), independent certified public accountants, to examine the financial statements of the Fund for the fiscal year ending March 31, 1985. The Fund knows of no direct or indirect financial interest of such firm in the Fund. Such appointment is subject to ratification or rejection by the shareholders of the Fund. Unless a contrary specification is made, the accompanying proxy will be voted in favor of ratifying the selection of such accountants.

DH&S also acts as independent certified public accountants for Merrill Lynch & Co., Inc. and all of its subsidiaries and for the other investment companies for which FAMI or MLAM acts as investment adviser. The fees received by DH&S from these other entities are substantially greater, in the aggregate, than the total fees received by it from the Fund. The Trustees considered the fact that DH&S has been retained as the independent accountants for Merrill Lynch & Co., Inc. and the other

entities described above in their evaluation of the independence of DH&S with respect to the Fund.

Representatives of DH&S are expected to be present at the Meeting and will have the opportunity to respond to questions from shareholders and to make a statement if they so desire.

APPROVAL OF THE CONTINUANCE OF THE INVESTMENT ADVISORY AGREEMENT

Fund Asset Management, Inc. ("FAMI" or the "Investment Adviser") acts as the investment adviser for the Fund and provides the Fund with management services pursuant to an investment advisory agreement (the "Investment Advisory Agreement") which was most recently approved by the shareholders of the Fund on July 26, 1983. FAMI has acted as the investment adviser for the Fund since August 29, 1977.

On June 13, 1984, the Trustees of the Fund, including a majority of the Trustees who are not interested persons of the Fund, approved the continuance of the Investment Advisory Agreement for a period of one year, subject to shareholder approval at the Meeting. In their consideration of this matter, the Trustees have received extensive information relating to, among other things, alternatives to the FAMI arrangements, the nature, quality and extent of the advisory, administrative and other services provided to the Fund by FAMI and its affiliates (including Merrill Lynch), comparative data with respect to the advisory and management fees paid by other money market funds, the operating expenses and expense ratio of the Fund as compared to such funds and the performance of

the Fund as compared to the performance of other money market funds. The Trustees also have received information as to the costs of FAMI and its affiliates for providing services to the Fund and to the Cash Management Account financial service program of Merrill Lynch of which the Fund is a part.

For information with respect to two derivative actions concerning the advisory fees paid by the Fund, see "Pending Litigation and Legal Matters" on page 13.

Information Concerning FAMI

FAMI, a Delaware corporation, was incorporated in 1976 and is a wholly-owned subsidiary of Merrill Lynch Asset Management, Inc. ("MLAM"), which is a wholly-owned subsidiary of Merrill Lynch & Co., Inc. FAMI and MLAM act as the investment adviser for the companies listed below. In addition, MLAM offers portfolio management and portfolio analysis services to individuals and institutions. FAMI's balance sheet for its most recent fiscal year is appended to this Proxy Statement as Exhibit A.

The following table sets forth information relating to the investment companies for which FAMI or MLAM presently acts as the investment adviser:

Investment Company (1)	Net Assets at June 15, 1984 (in millions)	Management Fee: Rate (percentage of net assets)	Management Fee: First Breakpoint (in millions) (2)
Money Market Funds:			
Merrill Lynch Ready Assets Trust	$11,304.3	0.50%	$ 500
CMA Money Fund	13,276.0	0.50	500
CMA Government Securities Fund	1,389.2	0.50	500
CBA Money Fund	0.1	0.50	500
Merrill Lynch Institutional Fund Inc.	996.5	0.40	250
Merrill Lynch Government Fund Inc.	1,346.9	0.35	500
Financial Institutions Series Trust (3)			
ISU Money Maximizer Fund	18.2	0.50	—
The Overland Express Money Market Fund	239.9	0.50	—
Summit Cash Reserves Fund	426.2	0.55	500
Merrill Lynch Retirement Series Trust (4)			
Merrill Lynch Retirement Reserves Money Fund	1,295.8	0.50	1,000
Merrill Lynch U.S.A. Government Reserves	129.3	0.45	—

Investment Company (1)	Net Assets at June 15, 1984 (in millions)	Management Fee: Rate (percentage of net assets)	Management Fee: First Breakpoint (in millions) (2)
Equity Funds:			
Merrill Lynch Capital Fund, Inc.	256.1	0.50	250
Merrill Lynch Basic Value Fund, Inc.	263.9	0.60	100
Merrill Lynch Special Value Fund, Inc.	83.0	0.75	—
Merrill Lynch Pacific Fund, Inc. (5)	91.6	0.60	—
Merrill Lynch Phoenix Fund, Inc.	105.1	1.00	—
Merrill Lynch Fund For Tomorrow, Inc.	73.2	0.65	—
Merrill Lynch Corporate Dividend Fund, Inc.	27.6	(6)	(6)
Merrill Lynch International Holdings, Inc. (7)	0.1	1.00	—
Sci/Tech Holdings, Inc. (8)	465.9	1.00	—

Investment Company (1)	Net Assets at June 15, 1984 (in millions)	Management Fee: Rate (percentage of net assets)	Management Fee: First Breakpoint (in millions) (2)
Corporate Bond Funds:			
Merrill Lynch Corporate Bond Fund, Inc.			
High Income Portfolio	229.4	0.55	250(9)
High Quality Portfolio	114.1	0.50	
Intermediate Term Portfolio	27.1	0.50	
The Corporate Fund Accumulation Program, Inc.	53.7	0.50	—
Merrill Lynch Equi-Bond 1 Fund, Inc.	13.5	0.45	—
Municipal Bond Funds:			
Merrill Lynch Municipal Bond Fund, Inc.			
Insured Portfolio	642.0	0.40	250(9)
Limited Maturity Portfolio	429.5	0.40	
High Yield Portfolio	379.5	0.50	
The Municipal Fund Accumulation Program, Inc.	135.9	0.50	—
CMA Tax-Exempt Fund	3,175.2	0.50	500
Merrill Lynch Institutional Tax-Exempt Fund	95.7	0.50	—

Investment Company (1)	Net Assets at June 15, 1984 (in millions)	Management Fee: Rate (percentage of net assets)	Management Fee: First Breakpoint (in millions) (2)
Other:			
Merrill Lynch Series Fund, Inc. (10)			
Money Reserve Portfolio	123.1	0.50	
Intermediate Gov't. Bond Portfolio	15.4	0.50	
Long-Term Corporate Bond Portfolio	13.7	0.50	250(9)
Capital Stock Portfolio	14.2	0.50	
Growth Stock Portfolio	9.8	0.50	
Merrill Lynch Variable Series Inc. (11)			
Merrill Lynch Reserve Assets Fund	16.1	0.50	500
Merrill Lynch U.S. Government Money Fund	2.1	0.50	500
Merrill Lynch Prime Bond Fund	4.7	0.50	
Merrill Lynch High Current Income Fund	2.5	0.55	250(9)
Merrill Lynch Quality Equity Fund	5.9	0.50	250
Merrill Lynch Equity Growth Fund	3.3	0.75	—

(1) FAMI is the investment adviser for each investment company other than Merrill Lynch Ready Assets Trust, Merrill Lynch U.S.A. Government Reserves, Merrill Lynch Retirement Series Trust, Merrill Lynch Capital Fund, Inc., Merrill Lynch Pacific Fund, Inc., Merrill Lynch Fund For Tomorrow, Inc., Merrill Lynch Corporate Dividend Fund, Inc., Merrill Lynch International Holdings, Inc., Sci/Tech Holdings, Inc., Merrill Lynch Series Fund, Inc., Merrill Lynch Variable Series Funds, Inc. and ISU Money Maximizer Fund of Financial Institutions Series Trust, which are advised by MLAM.

(2) The term break point refers to the level of net assets at which the advisory fee rate is reduced.

(3) A series fund presently consisting of The Overland Express Money Market Fund, ISU Money Maximizer Fund and Summit Cash Reserves Fund. Of the indicated management fee, FAMI receives a fee of 0.25% of average net assets from The Overland Express Money Market Fund and 0.275% of average net assets from Summit Cash Reserves Fund for acting as an investment manager for each of them, and MLAM receives a fee of 0.25% of average net assets from ISU Money Mazimizer Fund for acting as an investment manager.

(4) A series fund presently consisting only of the Merrill Lynch Retirement Reserves Money Fund.

(5) Of the indicated management fee, MLAM receives a fee of 0.50% of average net assets for acting as an investment adviser.

(6) MLAM does not receive a management fee from the fund. Instead, the management fee is charged directly to each shareholder account at the rate of 0.75% of the average daily net asset value of each shareholder account up to $100,000, with progressively lower rates for larger accounts.

(7) Of the indicated management fee, MLAM receives a fee of 0.65% of average net assets for acting as an

investment adviser and manager. MLAM also acts as one of the three investments advisers of World Fund S.A., which is not registered under the investment Company Act of 1940.

(8) Of the indicated management fee, MLAM receives a fee of 0.55% of average net assets for acting as an investment adviser and manager. MLAM also acts as one of the three investment advisers of Sci/Tech S.A., which is not registered under the Investment Company Act of 1940.

(9) The breakpoints are based upon the combined net assets of the portfolios.

(10) A series fund for investments in connection with the variable life insurance program of Monarch Life Insurance Company.

(11) A series fund for investments in connection with the variable annuity program of Family Life Insurance Company, an affiliate of FAMI.

FAMI has access to the expertise of its affiliate, Merrill Lynch Government Securities, Inc. ("GSI"), which is a wholly-owned subsidiary of Merrill Lynch & Co., Inc. In terms of dollar volume of trading, GSI is one of the largest dealers in United States Government securities and Government agency securities, acting both as a primary dealer and a secondary market trader. GSI is one of the reporting dealers in government securities who report their daily position and activity to the Federal Reserve Bank of New York. A subsidiary of GSI acts as a dealer in bankers' acceptances, certificates of deposit and commercial paper. See "Portfolio Transactions" herein for information with respect to the ability of the Fund to conduct portfolio transactions with GSI and its subsidiary. In addition, FAMI has access to the securities and economic research of Merrill Lynch.

Securities held by the Fund may also be held by, or be appropriate investments for, other funds or clients (collectively referred to as "clients") for which the Investment Adviser of MLAM acts as an investment adviser. Because of different investment objectives or other factors, a particular security may be bought for one or more clients when one or more clients are selling the security. If purchases or sales of securities for the Fund or other clients arise for consideration at or about the same time, transactions in such securities will be made, insofar as feasible, for the respective clients in a manner deemed equitable to all by the Investment Adviser or MLAM. To the extent that transactions on behalf of more than one client of the Investment Adviser or MLAM during the same period may increase the demand for securities being purchased or the supply of securities being sold, there may be an adverse effect on price.

The following table sets forth the name, title and principal occupation of the principal executive officer and each director of FAMI:

Name*	Title	Principal Occupation
Arthur Ziekel	President and Director	President of MLAM
Charles H. Ross, Jr.	Director	Chairman of Merrill Lynch International
Wallace O. Sellers	Director	Vice President – Diversification and Joint Ventures of Merrill Lynch & Co., Inc.

Mario J. Nigro	Director	Senior Vice President – Operations/Systems of Merril Lynch Individual Services

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*Mr. Zeikel is presently the President and a Trustee of the Fund. The address of Mr. Zeikel is 633 Third Avenue, New York, New York 10017, which is also the address of FAMI and MLAM. The address of each of the other persons is 165 Broadway, New York, New York 10080, which is also the address of Merrill Lynch & Co., Inc. and Merrill Lynch.

Terms of the Investment Advisory Agreement

Pursuant to the Investment Advisory Agreement, subject to the direction of the Trustees, the Investment Adviser is responsible for the actual management of the Fund's portfolio and constantly reviews the Fund's holdings in light of its own research analysis and that from other relevant sources. The responsibility for making decisions to buy, sell or hold a particular security rests with the Investment Adviser. The Investment Adviser performs certain of the other administrative services and provides all the office space, facilities, equipment and necessary personnel for portfolio management of the Fund.

Advisory Fee. The Investment Advisory Agreement provides that, as compensation for its services to the Fund, the Investment Adviser shall receive from the Fund at the end of each month a fee at the annual rate of 0.50% of average net assets not exceeding $500 million, 0.425% of average net assets in excess of $500 million but not in

excess of $1 billion and 0.375% of average net assets in excess of $1 billion. For the years ended March 31, 1982, 1983 and 1984, the total advisory fees paid to the Investment Adviser aggregated $38,417,543, $55,450,190 and $48,546,617, respectively. At July 16, 1984, the net assets of the Fund aggregated approximately $13.4 billion. At this asset level, taking into account the various breakpoints, the annual rate of the advisory fee is approximately .38% of the average net assets. Based upon this asset level and rate, the annual advisory fee would aggregate approximately $51.1 million.

Payment of Expenses. The Investment Advisory Agreement obligates the Investment Adviser to provide investment advisory services, to furnish administrative services, office space and facilities for management of the Fund's affairs, to pay all compensation of and furnish office space for officers and employees of the Fund, as well as the fees of all Trustees of the Fund who are affiliated persons of Merrill Lynch & Co., Inc. or any of its subsidiaries. Except for certain expenses incurred by the Distributor (see "Distribution and Shareholder Servicing Arrangements"), the Fund pays all other expenses incurred in the operation of the Fund, including, among other things, taxes, expenses for legal and auditing services, costs of printing proxies, reports, prospectuses and statements of additional information sent to shareholders, charges of the Custodian and Transfer Agent, expenses of redemption of shares, Securities and Exchange Commission fees, expenses of registering the shares under Federal and state securities laws, fees and expenses of unaffiliated trustees, accounting and pricing costs

(including the daily calculation of net asset value), insurance, interest, brokerage costs, litigation and other extraordinary or non-recurring expenses, and other expenses properly payable by the Fund. Accounting services are provided for the Fund by the Investment Adviser and the Fund reimburses the Investment Adviser for its costs in connection with such services. For the fiscal year ended March 31, 1984, the amount of such reimbursement was $106,850.

Certain of the states in which the shares of the Fund are qualified for sale impose limitations on the expenses of the Fund. At the date of this Proxy Statement, the most restrictive annual expense limitations require that the Investment Adviser (a) reimburse the Fund for advisory fees received by it from the Fund, to the extent that the Fund's aggregate ordinary operating expenses (excluding interest, taxes, brokerage fees and commissions and extraordinary charges such as litigation costs) exceed in any fiscal year 25% of its total investment income and (b) reimburse the Fund in any amount necessary to prevent such operating expenses of the Fund from exceeding in any fiscal year 2.0% of the Fund's first $10 million of average net assets, 1.5% of the next $20 million of average net assets and 1.0% of the remaining average net assets. No fee payment will be made to the Investment Adviser during any year which will cause such expenses to exceed the pro rata expense limitation at the time of such payment.

Duration and Termination. If the continuance of the Investment Advisory Agreement is approved by the shareholders of the Fund, unless earlier terminated as described below, the agreement will remain in effect until

July 31, 1985 and will continue in effect from year to year thereafter if approved annually (a) by the Trustees of the Fund or by a majority of the outstanding voting securities of the Fund and (b) by a majority of Trustees who are not parties to such contract or interested persons (as defined in the Investment Company Act of 1940) of any such party. Such contract is not assignable and may be terminated without penalty on 60 days' written notice at the option of either party thereto or by the vote of the shareholders of the Fund.

DISTRIBUTION AND SHAREHOLDER SERVICING ARRANGEMENTS

The shares of the Fund are offered exclusively to participants in the Cash Management Account® financial service program ("CMA®") of Merrill Lynch to provide a medium for the investment of free credit cash balances held in CMA accounts. A CMA account is a conventional Merrill Lynch securities margin account which is linked to the Fund and two other money market funds (CMA Government Securities Fund and CMA Tax-Exempt Fund), money market deposit accounts maintained with depository institutions and to a Visa check/card account ("Visa Account"). A subscriber to the CMA program may automatically invest his free credit balances periodically in shares of the Fund and earn a return thereon pending further investment of such funds in other aspects of the CMA program or utilization through the Visa Account. The shares of the Fund are offered at net asset value without a sales charge. Merrill Lynch charges CMA customers a service fee, which presently is $50 per year, to defray its costs of maintaining the CMA account.

Merrill Lynch has acted as the Distributor for the Fund since the Fund commenced operations in 1977. On June 13, 1984, the Trustees of the Fund, including a majority of the non-interested Trustees, approved the continuance of the Distribution Agreement with Merrill Lynch for a period of one year.

The Distribution Agreement is renewable annually and may be terminated upon 60 days' written notice by either party. The Distribution Agreement obligates Merrill Lynch to pay certain expenses in connection with the offering of the shares of the Fund. After the prospectuses, statements of additional information and periodic reports have been prepared, set in type and mailed to shareholders, Merrill Lynch pays for the printing and distribution of copies thereof used in connection with the offering to investors. Merrill Lynch also pays for other supplementary sales literature and advertising costs.

Distribution and Shareholder Servicing Plan

Effective July 26, 1983, the Fund adopted a Distribution and Shareholder Servicing Plan (the "Plan") in compliance with Rule 12b-1 under the Investment Company Act of 1940 pursuant to which the Fund is authorized to pay Merrill Lynch a distribution fee under the Distribution Agreement at the end of each month at the annual rate of 0.125% of average daily net assets of the Fund. Merrill Lynch is obligated to expend the entire amount of the fee for compensation to Merrill Lynch account executives and other directly involved branch office personnel for selling shares of the Fund and for providing direct personal services to shareholders. These services have

included handling purchase and redemption orders for Fund shares and furnishing information as to the status of Fund accounts. On June 13, 1984, the Trustees of the Fund, including the non-interested Trustees, approved the continuance of the plan for a period of one year. In their consideration of this matter, the Trustees considered all factors they deemed relevant, including information as to the benefits of the Plan to the Fund and its shareholders. After considering these factors, the Trustees determined that there is a reasonable likelihood that the continuance of the Plan would benefit the Fund and its shareholders.

For the period September 1, 1983 (the date the Plan was implemented) to March 31, 1984, $9.5 million was payable to Merrill Lynch pursuant to the Plan. Had the Plan been in effect for the year ended March 31, 1984, approximately $15.9 million would have been payable to Merrill Lynch pursuant to the Plan (based upon average net assets of approximately $12.7 billion). At June 1, 1984, the net assets of the Fund aggregated approximately $13.1 billion. At this asset level, the annual distribution fee payable to Merrill Lynch pursuant to the Plan would aggregate approximately $16.4 million.

PORTFOLIO TRANSACTIONS

The Fund has no obligation to deal with any dealer or group of dealers in the execution of transactions in portfolio securities. Subject to policy established by the Trustees and officers of the Fund, the Investment Adviser is primarily responsible for the Fund's portfolio decisions and the placing of the Fund's portfolio transactions. In

placing orders, it is the policy of the Fund to obtain the best net results, taking into account the firm's general execution and operational facilities, the type of transaction involved and other factors such as the firm's risk in positioning the securities involved. While the Investment Adviser generally seeks reasonably competitive spreads or commissions, the Fund will not necessarily be paying the lowest spread or commission available. The Fund's policy of investing in securities with short maturities will result in high portfolio turnover.

The money market securities in which the Fund invests are traded primarily in the over-the-counter market. Bonds and debentures are usually traded over-the-counter, but may be traded on an exchange. Where possible, the Fund will deal directly with the dealers who make a market in the securities involved except in those circumstances where better prices and execution are available elsewhere. Such dealers usually are acting as principal for their own account. On occasion, securities may be purchased directly from the issuer. Money market securities are generally traded on a net basis and do not normally involve either brokerage commissions or transfer taxes. The cost of portfolio securities transactions of the Fund will primarily consist of dealer spreads and underwriting commissions.

Under the Investment Company Act of 1940, persons affiliated with the Fund are prohibited from dealing with the Fund as a principal in the purchase and sale of securities unless a permissive order allowing such transactions is obtained from the Securities and Exchange Commission. Since over-the-counter transactions are usually principal transactions, affiliated persons of the Fund,

including Merrill Lynch Government Securities, Inc. ("GSI") and Merrill Lynch, may not serve as the Fund's dealer in connection with such transactions except pursuant to the exemptive order described below. Affiliated persons of the Fund may serve as its broker in over-the-counter transactions conducted on an agency basis. Under the Investment Company Act of 1940, the Fund may not purchase securities from any underwriting syndicate of which Merrill Lynch is a member except pursuant to an exemptive order or rules adopted by the Securities and Exchange Commission. Of the money market securities in which the Fund invests, generally only United States Government agency securities are sold in underwritings.

In 1981 and 1983, the Securities and Exchange Commission issued orders permitting the Fund to conduct principal transactions with GSI in U.S. Government and Government agency securities and with a subsidiary of GSI in certificates of deposit and other short-term bank money instruments and commercial paper. These orders contain a number of conditions, including conditions designed to insure that the price to the Fund available from GSI or its subsidiary is better than that available from other sources. GSI and its subsidiary have informed the Fund that they will in no way, at any time, attempt to influence or control the activities of the Fund or the Investment Adviser in placing such principal transactions. The permissive orders allow GSI or its subsidiary to receive a dealer spread on any transaction with the Fund no greater than its customary dealer spread for transactions of the type involved. Generally such spreads

do not exceed 0.25% of the principal amount of the securities involved. Information as to the transactions with GSI and its subsidiary pursuant to such orders for the last three years are set forth below:

Year ended March 31,	Number of Transactions	Approximate Aggregate Dollar Amount (in millions)
1982	12	$248
1983	32	642
1984	73	1,419.2

The transactions with GSI and its subsidiary during the fiscal year ended March 31, 1984 comprised less than 1/2 of 1% of total portfolio transactions of the Fund in terms of both total transactions conducted and dollar amount.

The Trustees of the Fund have considered the possibilities of recapturing for the benefit of the Fund expenses of possible portfolio transactions, such as dealer spreads and underwriting commissions, by conducting such portfolio transactions through affiliated entities, including GSI and Merrill Lynch. After considering all factors deemed relevant, the Trustees made a determination not to seek such recapture. The Trustees will reconsider this matter from time to time. The Investment Adviser has arranged for the Custodian to receive any tender offer solicitation fees on behalf of the Fund payable with respect to portfolio securities of the Fund.

The Fund does not expect to use one particular dealer, but, subject to obtaining the best net results as

described above, dealers who provide supplemental investment research to the Investment Adviser may receive orders for transactions by the Fund. Information so received will be in addition to and not in lieu of the services required to be performed by the Investment Adviser under its Investment Advisory Agreement and the expenses of the Investment Adviser will not necessarily be reduced as a result of the receipt of such supplemental information. Such supplemental information may be used by the Investment Adviser in managing other investment companies or advisory accounts.

PENDING LITIGATION AND LEGAL MATTERS

The Fund, the Investment Adviser and MLAM have been named as defendants in two shareholder derivative actions entitle *Rosenfeld v. MLAM* (80 Civ. 6122) and *Kalman v. CMA Money Trust* (81 Civ. 2574) brought in the United States District Court for the Southern District of New York in October, 1980 and April, 1981, respectively. The *Rosenfeld* action also names Merrill Lynch & Co., Inc. as a defendant and the *Kalman* action names five of the present Trustees and two former Trustees, who constitute all of the Trustees at the time the action was commenced, as individual defendants. Both complaints allege that the Investment Adviser, MLAM and Merrill Lynch & Co., Inc. have breached fiduciary duties owed by them to the Fund by charging advisory fees which are excessive and disproportionate to the services rendered by the Investment Adviser. The *Kalman* action additionally charges that the individual defendants breached fiduciary duties owed by them to the Fund. An amended complaint filed in January 1984 in the *Rosenfeld* action names Merrill Lynch as a

defendant. The amended complaint charges that the proxy statement seeking shareholder approval of the Distribution and Shareholder Servicing Plan (the "Distribution Plan") referred to above and the Distribution Agreement failed to provide material information regarding compensation to Merrill Lynch and that the Trustees breached fiduciary duties in approving the Distribution Plan and the Distribution Agreement. The amended complaint also charges that the Fund's proxy statement failed to disclose material information with respect to the Investment Advisory Agreement, the Distribution Plan and the Distribution Agreement. The *Rosenfeld* action seeks repayment to the Fund of actual damages and of payments made under the Investment Advisory Agreement, the Distribution Plan and the Distribution Agreement, as well as a declaration that the same are null and void, together with reasonable attorneys' fees, costs and disbursements. The *Kalman* action seeks an accounting by all defendants for the fees paid to the Investment Adviser, repayment to the Fund of any excessive advisory fees, payment to the Fund of defendants' profits or any damages incurred by the Fund and also seeks to enjoin the Fund from continuing to pay fees pursuant to its Investment Advisory Agreement, to enjoin the defendants from continuing the Investment Advisory Agreement and a declaration that the Investment Advisory Agreement is void. The Investment Adviser believes that there are meritorious defenses to these actions and, accordingly, has interposed an answer to the complaints in the *Rosenfeld* and *Kalman* actions denying their substantive allegations and seeking dismissal of the actions. Inasmuch as the complaints in *Rosenfeld* and *Kalman* relate to

the rights and obligations of the Fund, including its existing contractual obligations with its Investment Adviser which the Fund believes are valid and binding, the Fund has interposed an answer to the complaints in *Rosenfeld* and *Kalman* denying their substantive allegations notwithstanding that the plaintiff in *Rosenfeld* and *Kalman* purports to have instituted these actions for the benefit of the Fund.

From time to time, certain state administrative agencies have raised questions as to whether the operation of the CMA program constitutes banking under the laws of their states, Merrill Lynch is not a bank and it believes that the operation of the CMA program does not constitute banking under the laws of any state. Merrill Lynch intends to fully contest and resist any regulatory challenges to the CMA program. Final adverse rulings in any state that the CMA program constitutes unauthorized banking therein could force the Fund to liquidate shares of residents in such state or to cease offering its shares in such state as part of the CMA program.

The rapid growth in the assets of money market funds in the past several years has created a number of policy concerns with respect to the effect of such growth on other financial institutions. As a result, legislation has been proposed in the U.S. Congress and in certain states which, if enacted, could require a modification of the Fund's operations or curtail the sale of its shares. The operations of the Fund could also be affected by Federal regulatory developments. From March to July, 1980, the Fund was subject to non-interest bearing special deposit requirements imposed by the Board of Governors of the

Federal Reserve System. During such period, the Fund ceased offering shares to new shareholders.

ADDITIONAL INFORMATION

The expense of preparation, printing and mailing of the enclosed form of proxy and accompanying Notice and Proxy Statement will be borne by the Fund. The Fund will reimburse banks, brokers and others for their reasonable expenses in forwarding proxy solicitation material to the beneficial owners of the shares of the Fund.

Approval of the continuance of the Investment Advisory Agreement requires the vote of a majority of the outstanding voting securities of the Fund which, under the Investment Company Act of 1940, is the vote (a) of 67% or more of the shares of the Fund present at the Meeting if the holders of more than 50% of the outstanding shares are present or represented by proxy, or (b) of more than 50% of the outstanding shares, whichever is less. In order to obtain the necessary quorum at the Meeting, supplementary solicitation may be made by mail, telephone, telegraph or personal interview by officers of the Fund. It is anticipated that the cost of such supplementary solicitation, if any, will be nominal. In addition, the Fund may retain an outside firm to solicit proxies on behalf of the Trustees of the Fund. The fees and expenses of any such firm will be borne by the Investment Adviser.

The Declaration of Trust establishing the Fund, dated June 17, 1977, a copy of which, together with all amendments thereto (the "Declaration"), is on file in the office of the Secretary of the Commonwealth of Massachusetts,

provides that the name of the Fund refers to the Trustees under the Declaration collectively as Trustees, but not as individuals or personally; and no Trustee, shareholder, officer, employee or agent of the Fund shall be held to any personal liability, nor shall resort be had to their private property for the satisfaction of any obligation or claim of the Fund but the Trust Estate only shall be liable.

Proposals of Shareholders

Proposals of shareholders intended to be presented at the next annual meeting of shareholders of the Fund must be received by the Fund for inclusion in its proxy statement and form of proxy relating to that meeting by March 28, 1985.

By Order of the Trustees
PHILIP L. KIRSTEIN
Secretary

Dated: July 26, 1984

Exhibit A

AUDITORS' OPINION

Fund Asset Management, Inc.:

We have examined the balance sheet of Fund Asset Management, Inc. as of December 30, 1983. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet presents fairly the financial position of Fund Asset Management, Inc. at December 30, 1983, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

/s/ Deloitte Haskins & Sells
Deloitte Haskins & Sells
New York, New York
February 3, 1984

FUND ASSET MANAGEMENT, INC.

BALANCE SHEET

December 30, 1983

ASSETS

	Notes	
Cash		$ 911,492
Receivables from affiliated companies	2	18,737,661
Investment in leveraged leases	1,3	107,948,333
Investments in affiliated investment companies at the lower of cost or market (market $5,170,915)	2	5,076,544
Investment in limited partnership	2	49,000
TOTAL ASSETS		$132,723,030

LIABILITIES AND STOCKHOLDER'S EQUITY

LIABILITIES:		
Payable to Merrill Lynch & Co., Inc. and affiliates	2	$ 69,994,058
Payable to Merrill Lynch Asset Management, Inc.		2,434,454
Accrued liabilities and other payables		582,274
Deferred income taxes:		
Arising from leveraged leases	1,3	30,980,142
Other	4	391,693
Total liabilities		104,382,621

STOCKHOLDER'S EQUITY:	
Common stock, par value $1.00 per share – authorized 25,000 shares; issued 1,000 shares (no change during the year)	1,000
Additional paid-in capital (no change during the year)	24,000
Retained earnings	28,315,409
Total stockholder's equity	28,340,409
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	$132,723,030

See notes to balance sheet.

FUND ASSET MANAGEMENT, INC.

NOTES TO BALANCE SHEET, December 30, 1983

1. ACCOUNTING POLICIES

Organization – Fund Asset Management, Inc. (the "Company"), a wholly-owned subsidiary of Merrill Lynch Asset Management, Inc. ("MLAM"), which is a wholly-owned subsidiary of Merrill Lynch & Co., Inc. ("ML & Co."), serves as an investment adviser to various registered open-end investment companies. Beginning in 1983, the Company also became a lessor participant in certain leverage lease agreements.

Investment Tax Credit – Investment tax credits arising from leverage leases are recognized for financial accounting purposes ratably over the terms of the respective leases in the same proportion as income (loss) from such leases.

Provision For Uncollectibles – The Company records a provision for uncollectibles approximating one percent of its investment in leveraged leases. Pretax leasing income in an amount equivalent to the provision for uncollectibles is recognized when the provision for uncollectibles is recorded at the inception of the leases.

2. Transactions with Affiliates

The Company serves as investment adviser to The Corporate Fund Accumulation Program, Inc., The Municipal Fund Accumulation Program, Inc., Merrill Lynch Basic Value Fund, Inc., CMA Money Fund, CMA Tax-Exempt Fund, CMA Government Securities Fund, Merrill Lynch Municipal Bond Fund, Inc., Merrill Lynch Equi-Bond I Fund, Inc., Merrill Lynch Government Fund Inc., Merrill Lynch Institutional Fund Inc., Merrill Lynch Institutional Tax-Exempt Fund, Merrill Lynch Corporate Bond Fund, Inc., Merrill Lynch Special Value Fund, Inc. Merrill Lynch Phoenix Fund, Inc., and The Overland Express Money Market Fund and the Summit Cash Reserves Fund of the Financial Institutions Series Trust ("Affiliated Investment Companies" or "Funds"). The Company also serves as an administrator to The Mexico Fund, Inc.

The Company has entered into administrative agreements with Merrill Lynch, Pierce, Fenner & Smith Incorporated, Prudential-Bache Securities, Inc., and Dean Witter Reynolds, Inc. (the "Administrators"), whereby the Administrators will preform certain administrative duties, with respect to certain of the above-mentioned Affiliated Investment Companies, on behalf of the Company.

The "receivables from affiliated companies" of $18,737,661 consists of $9,738,828 due from ML & Co. and $8,998,833 due from the above-mentioned Affiliated Investment Companies.

ML & Co. is holder of the Company's excess cash, which is available on demand to meet current liabilities. The Company earns interest based on its average daily balances receivable from ML & Co.

The "payable to Merrill Lynch & Co., Inc. and affiliates" arising from leveraged lease transactions consists of the following:

Monies advanced to fund lease transactions	$130,991,541
Tax benefits allocated to the Company by ML&Co	(64,665,998)
Other	3,668,515
Total	$ 69,994,058

"Investments in affiliated investment companies" are as follows:

Merrill Lynch Institutional Tax-Exempt Fund	$2,025,412
CMA Tax-Exempt Fund	1,221,356
Merrill Lynch Basic Value Fund, Inc.	214,696
CMA Money Fund	196,669
CMA Government Securities Fund	128,502
Other	1,289,909
Total	$5,076,544

The Company has an arrangement with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF & S") providing that the Company, which receives revenue as investment adviser to the CMA Money Fund, CMA Tax-Exempt Fund, and CMA Government Securities Fund ("CMA Funds"), reimburse MLPF & S for certain costs incurred in processing transactions involving shares of the CMA Funds.

In June 1983, the Company purchased a 49% interest in ML Plainsboro Limited Partnership whose other partners are affiliates of the Company. Profits and losses will be allocated to the Company based on its percentage interest.

3. Investment in Leveraged Leases

The Company is a lessor participant in leveraged lease agreements. Pertinent information relating thereto is summarized as follows:

Type of Property	Length of Lease	Equity Investment	Estimated Residual Value of Leased Property
Chemical tanker	20 Years	41.74%	15%
Generating plant	25 Years	36.12%	15%
Satellite transponders	7.5 Years	29.79%	7.5%

Financing beyond the Company's equity interest in the purchase price of the properties was furnished by outside parties in the form of long-term debt that provides for no recourse against the Company and is secured by a first lien on the properties and related rentals. At the end of

the respective lease terms, ownership of the properties remains with the Company.

For Federal income tax purposes, the Company receives the investment tax credit and has the benefit of tax deductions for (i) depreciation on the entire amount of leased assets and (ii) interest on the outstanding long-term debt. For state and local tax purposes, the Company also receives the benefits of tax deductions from (i) and (ii) above. Since during the early years of the leases those deductions exceed the Company's lease rental income, substantial excess deductions are available to be applied against the Company's other income and the consolidated income of ML & Co. The Company's results of operations are included in ML & Co.'s consolidated Federal income tax return. In the later years of these leases, rental income will exceed the related deductions and taxes will be payable (to the extent that net deductions arising from additional leveraged lease transactions do not offset such net lease income). Deferred taxes have been provided to reflect these timing differences.

The Company's net investment in leveraged leases is composed of the following:

Rentals receivable (net of principal and interest on the non-recourse debt)....	$121,655,117
Estimated residual values on leased assets..............................	44,837,103
Less: Unearned & deferred income...	(57,343,887)
Allowance for uncollectibles......	(1,200,000)
Investment in leveraged leases	107,948,333

Less: Deferred taxes arising from leveraged leases	(30,980,142)
Net investment in leveraged leases	$ 76,968,191

4. Income Taxes

The result of operations of the Company are included in the consolidated Federal income tax return of ML & Co. It is the policy of ML & Co. to allocate the consolidated tax or benefit associated with such operating results to its respective subsidiaries. The Company's current liability for Federal, state and local income taxes is transferred monthly to ML & Co. through the inter-company account with MLAM.

Deferred income taxes other than those arising from leveraged leases resulted principally from timing differences between accrued liabilities recognized for accounting purposes and amounts claimed as deductions for tax purposes.

5. Litigation

In October 1980 and March 1981, two shareholders of the CMA Money Fund (the "Money Fund") commenced separate legal actions against the Company, which allege that excessive advisory fees were paid by the Money Fund to the Company. Additionally, one of these shareholder actions seeks to recover, on behalf of the Money Fund, payments made by it to MLPF & S sales personnel pursuant to a sales plan promulgated pursuant to SEC Rule 12b-1. Resolution of these lawsuits could result in cash payments by the Company as well as a reduction in the

fee schedule pursuant to which the Company is compensated for managing the Money Fund. In the opinion of management, such pending lawsuits will be resolved with no material adverse effect on the financial condition of the Company.

1. ELECTION OF TRUSTEES

   (INSTRUCTION To withhold authority to vote for any individual nominee, strike a line through the nominee's name in the list below) Howard O. Colgan, Jr., Ronald W. Forbes, Thomas H. Lenagh, Richard T. O'Reilly, Richard R. West, Marc A. White, Arthur Zeikel

FOR all nominees listed below
(except as marked to the contrary below) [ ]

WITHHOLD AUTHORITY
to vote for all nominees listed below [ ]

	FOR	AGAINST	ABSTAIN
2. Proposal to ratify the selection of Deloitte Haskins & Sells as the independent public accountants of the Fund	[ ]	[ ]	[ ]
3. Proposal to approve the continuance of the investment Advisory Agreement between the Fund and Fund Asset Management Inc	[ ]	[ ]	[ ]

4. In the discretion of such proxies, upon such other business as may properly come before the meeting or any adjournment thereof

Please sign exactly as name appears below. When shares are held by joint tenants, both should sign. When signing as attorney, as executor, administrator, trustee or guardian, please give full titles as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

Dated 1984

X....................................

Signature

X....................................

Signature, if held jointly

Please mark boxes [ ] or [X] in blue or black ink.
Sign, Date and Return the Proxy Card Promptly Using the Enclosed Envelope.

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED STOCKHOLDERS. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED FOR PROPOSALS 1, 2, 3, and 4.

Please sign exactly as name appears below. When shares are held by joint tenants, both should sign. When signing as attorney, as executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.

Dated ________________________, 1984

____

(*Signature*)

____

(*signature if held jointly*)

PLEASE MARK, SIGN, DATE AND RETURN
THE PROXY CARD PROMPTLY
USING THE ENCLOSED RETURN ENVELOPE